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APPENDIX

Supreme Court of the United States

OCTOBER TERM, 1968

No. 41

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

—v.—

NATIONAL SECURITIES, INC., ET AL.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE NINTH CIRCUIT**

**PETITION FOR CERTIORARI FILED MARCH 4, 1968
CERTIORARI GRANTED APRIL 22, 1968**

Supreme Court of the United States

OCTOBER TERM, 1968

No. 41

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

—v.—

NATIONAL SECURITIES, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE NINTH CIRCUIT

TABLE OF CONTENTS

	Page
Relevant docket entries	1
Complaint for Injunction	11
Motion for temporary restraining order and preliminary injunction	25
Excerpt from affidavit of W. Stevens Tucker in support of motion for temporary restraining order and preliminary injunction	27
Excerpts from exhibits included in affidavit of W. Stevens Tucker:	29
Excerpt from minutes of special meeting of board of directors of Producers Life Insurance Company, Monday, April 27, 1964	29
Exhibit 8, Producers Life Insurance Company, flow chart of escrow—April 27, 1964	31
Exhibit 8, Management agreement by and between National Securities, Inc. and Producers Life Insurance Company, dated May 15, 1964	33

Table of Contents—Continued

Page

Excerpts from exhibit 9, Notice of special meeting of stockholders and proposed merger, dated November 27, 1964; Consolidation agreement and plan of reorganization attached thereto	40
Excerpts from Exhibit 10, Letter to stockholders of Producers Life Insurance Company, dated November 27, 1964	46
Temporary restraining order	55
Excerpts from exhibits included in supplemental affidavit of W. Stevens Tucker:	59
Exhibit A, Notice to shareholders of Producers Life Insurance Company dated January 1, 1965	59
Exhibit C-2, Booklet of Producers Life Insurance Company entitled "Headquarters Report"	60
Answer of the defendants	65
Excerpt from affidavit of Robert H. Wallace	72
Excerpts from partial transcript of proceedings on application for preliminary injunction	72
Order and judgment dropping certain defendants	75
Motion and order	77
Order on motions presented July 12, 1965	79
Amended and supplemental complaint for injunction	81
Answer of defendants to amended and supplemental complaint	101
Motion for judgment on the pleadings or in the alternative for summary judgment	109
Affidavit of Robert H. Wallace	110
Motion for permission to amend complaint to add parties defendant	112
Memorandum on plaintiff's motion to amend to add parties defendant	114
Exhibits, Letters to shareholders of Producers Life Insurance Company, dated:	
December 4, 1964, Exhibit 32	117
December 18, 1964, Exhibit 37	118
January 1, 1965, Exhibit 39	120
February 23, 1965, Exhibit 41	123

Table of Contents—Continued

Page

Excerpts from the "Annual Statement for the year 1964 of Producers Life Insurance Company" as filed with the State of Nevada on March 30, 1965 [Exhibit 13] _____	126
Excerpts from the "Annual Statement for the year 1964 of the National Life Insurance Company" as filed with the State of Nevada on March 1, 1965 [Exhibit 14] _____	128
Excerpts from exhibit 15 entitled "Form S-1 with Financials as of December 31, 1964 for National Securities, Inc." _____	131
Order granting motion for protective order _____	136
Order denying plaintiff's motion to amend to add parties defendant _____	137
Opinion of the District Court _____	139
Judgment granting defendant's motion for judgment on the pleadings _____	145
Notice of appeal _____	146
Designation of record _____	147
Opinion of the Court of Appeals for the Ninth Circuit _____	148
Order Allowing Certiorari _____	163

THE STATE OF CALIFORNIA

BEFORE ME, the undersigned authority, on this day personally appeared _____

known to me to be the person whose name is subscribed to the foregoing instrument,

and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

Given under my hand and seal of office this _____ day of _____, 19____.

Notary Public for the State of California.

My commission expires this _____ day of _____, 19____.

Notary Public for the State of California

My commission expires this _____ day of _____, 19____.

Notary Public for the State of California

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Notary Public for the State of California

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

No. 21,146

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

NATIONAL SECURITIES, INC., ET AL., APPELLEE

APPENDIX

[1]

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
1965	
Mar. 30	1. File Plaintiff's Complaint for Injunction.
Mar. 30	2. File Plt's Motion for Temporary Restraining Order and Preliminary Injunction.
Mar. 30	3. File Affidavit of W. Stevens Tucker in support of Motion.
Mar. 30	4. Enter and File Temporary Restraining Order that expires on April 9, 1965 at 4:50 p.m.
Mar. 30	5. Enter and File Order to show cause on Motion for Preliminary Injunction returnable on April 9, 1965 at 9:30 a.m. Date Order or Judgment Noted, CAM.

DATE

PROCEEDINGS

1965

- Mar. 31 — Issue Summons.
- Apr. 5 6. File Defts' Notice of taking deposition of W. Stevens Tucker.
- Apr. 5 7. File Summons with Marshal's return showing service of complaint, motion for temporary restraining order, memorandum, affidavit etc. made upon Ernest A. Richards; Bonnie B. Billbrey; Producers Thrift and Loan Co.; Richard G. Johnson; William R. Reedy; Robert H. Wallace; Robert C. Bohannon, Jr.; National Life and Casualty Ins. Co.; National Securities, Inc.; Arthur W. Saffert; Producers Life Ins. Co.; Ted Wilkins; Breeferd W. Large, Jr.; Joseph B. Setter and John S. Barrett.
- Apr. 9 — Minute Entry: Order to show cause on for hearing in Chambers. Richard Gormley pres. for pltf. John Madden pres. for deft Producers Thrift & Loan Co. Robert W. Perry pres. for defts Johnson Richards, Billbrey and Richards. John Frank and Jeremy Butler pres. for remaining defts. It is ordered that this matter be passed for hearing before Judge William C. Mathes on Friday, April 16, 1965 at 9 a.m.; and that temporary restraining order remain in effect until said date. All counsel for defts state they do not stipulate to Rule 65. Date Order or Judgment Noted, CAM.
- Apr. 13 8. File Supplemental Affidavit of W. Stevens Tucker.
- Apr. 13 9. File Certificate of Service of affidavits.
- Apr. 13 10. File Affidavit of J. Grant Iverson.
- Apr. 13 11. File Affidavit of Thomas L. North.

DATE

PROCEEDINGS

1965

- Apr. 15 12. File Motion of deft Producers Thrift & Loan Company for order dropping said defendant and to Dismiss complaint as to said deft., with Memorandum and Notice of hearing on Friday, April 16, 1965 at 9 a.m.
- Apr. 15 13. File defts Johnson, Richards, Reedy and Bilbery's resistance to Plt's Motion for Preliminary Injunction.
- Apr. 15 14. File ANSWER of the defts National Securities, Inc.; National Life & Casualty Insurance Co.; Robert H. Wallace; Robert C. Bohannon, Jr.; Arthur W. Saffert; Ted Wilkins; John S. Barrett; Joseph B. Setter; Breeferd W. Large, Jr.; and Producers Life Insurance Company.
- Apr. 16 15. File Defts' Motion for order dropping defts Richard G. Johnson, Ernest A. Richards, William P. Reedy and Bonnie B. Bilbrey; and to Dismiss Complaint.
- Apr. 16 16. File Affidavit of Robert H. Wallace. (Deft's Exhibit B)
- Apr. 16 17. File Affidavit of Arthur W. Saffert. (Deft's Exhibit C)
- Apr. 16 18. File Affidavit of Robert A. Mills. (Deft's Exhibit D)
- Apr. 16 — Minute Entry: Plt's Motion for Preliminary Injunction on for hearing. W. Stevens Tucker and F. E. Kennamre, Jr. pres. for the pltf. John Frank, A. Gordon Oldsen, Jeremy Butler and Robert Mills are pres. for defts National Security Life and Casualty Ins.; Robert H. Wallace, Robert C. Bohannon, Jr., Arthur W. Saffert, Ted Wilkins, John S. Barrett, Joseph B. Setter, Bruferd W. Large, Jr. and Producers Life Ins. Co. Roger Perry is pres. for defts Johnson, Richards, Reedy and Bilbrey. John Madden is pres. for deft Producers Thrift &

DATE

PROCEEDINGS

1965**Apr. 16 —
(Continued)**

Loan. Motion for Order dropping debts Johnson Richards Reedy & Bilbrey and Motion for Order dropping Producers Thrift & Loan are argued, Court reserves ruling. Hearing is had on Motion for Preliminary Injunction. Counsel for pltf moves to insert the name of Arthur W. Saffert on page 2, line 3 following the name of Bilbrey and page 12, line 6 following

[2]

the name of Bilbrey in the original complaint. It is Ordered interlineation may be made on said pages in said original complaint. Pltf's Exhibits 13, 14, 1 through 12, inclusive, 16, 17 and 18 admitted. Counsel for debts moves for judgment on the case as made and for denial of the application for preliminary injunction. It is Ordered that said motion is denied. Debts' Exhibits A, B, C, D and E admitted. On stipulation of counsel, Order debts Ex. F for ident. and E in evidence may be withdrawn to make photocopies and substituted for originals. Motion for preliminary Injunction argued. On stipulation of counsel It is Ordered the complaint is dismissed without prejudice as to debts Johnson, Richards, Reedy, Bilbrey and Producers Thrift and Loan Co. Counsel for pltf to prepare written form of Order for Dismissal. Counsel for debts National Securities et al moves for an order of dismissal, and to deny the application for preliminary injunction without prejudice. Said motions argued. The case stands submitted to the Court. Subsequently all counsel being present, Motion vacating part of temporary restraining order and containing all matters until called up by counsel and form of order thereon are presented by the Court and Order signed and filed. Data Order or Judgment Noted, WCMathes

DATE**PROCEEDINGS****1965**

- Apr. 16 19. File Response of the National Securities Producers Group to Application for Preliminary Injunction.
- Apr. 16 20. File Brief and Opinions in conjunction with the Brief of the Nat'l Securities, Inc.—producers group.
- Apr. 16 21. Enter and File Order and Judgment Dropping debts Richard G. Johnson, Ernest A. Richardson, William P. Reedy, Bonnie B. Bilbrey and Producers Thrift & Loan Company. Date Order or Judgment Noted, WCM
- Apr. 16, — 8 conformed copies of Order and Judgment issued to counsel.
- Apr. 16 22. File Motion of debts Nat'l Securities, Inc., Nat'l Life & Casualty Ins. Co.; Robert H. Wallace, Robert Bohannon, Jr., Arthur W. Saffert, Ted, Wilkins, Don S. Barret, Joseph B. Setter, Breeferd W. Large, Jr. and Producers Life Ins. Co. that the temporary restraining order be vacated with exceptions; Enter and file Order that the temporary restraining order is vacated except as to the portions set forth in the motion as to which it is continued pending hearing of pltf's Motion for a preliminary injunction, or any other matters in this cause, which further hearing may be instituted upon application by any of the parties. This continuance shall be without prejudice to the claims of any of the parties as to the jurisdiction of this Court or as to the applicable law or facts. Date Order or Judgment Noted, WCM
- Apr. 26 23. File Reporter's Partial Transcript of proceedings dated April 16, 1965. Date Order or Judgment Noted, HRS

DATE

PROCEEDINGS

1965

- June 14 24. File Motion of the Securities and Exchange Commission under Rule 34 for the Production of Documents for inspection and copying, with notice of hearing on June 21, 1965 at 10 a.m. in courtroom No. 8.
- June 21 — Minute Entry: Motion of the pltf. for the production of documents for inspection and copying on for hearing. No appearance for pltf. Jeremy Butler pres. for deft. Upon written application of pltf and no objection on part of deft, It is Ordered that this case is assigned to the Hon. Wm. C. Mathes in San Francisco, Calif. for hearing on the said motion and for such other matters as the Court may desire to hear for the week of July 12, 1965 at the convenience of the court. Date Order or Judgment Noted WEC
- July 6 25. File Motion to Dismiss, of defts., and memorandum of authorities.
- July 6 26. File Motion of Defts. National Securities, Inc.; National Life & Casualty Insurance Company and Producers Life Ins. Co.; to Strike Plaintiff's Motion for Production of Documents for Inspection and Copying.
- July 6 27. File Deft's Notice of Hearing on Motions at San Francisco, Calif. before Hon. Wm. C. Mathes, at 2:00 p.m., and Certificate of Mailing Motions.
- July 7 28. File Defts' Response to Motion to Produce.
- [3]
- July 16 29. File Pltf's Certificate of service by mail in a sealed envelope addressed to Messrs. Lewis, Roca, Scoville, Beauchamp & Linton.

DATE	PROCEEDINGS
------	-------------

1965

- July 16 80. Docket Pltf's Memorandum in Reply to Response of National Securities—Producers Group to Application for Preliminary Injunction, filed Jul. 12, 1965.
- July 16 31. Docket Pltf's Notice of Hearing on Motion, filed July 12, 1965.
- July 16 32. Docket Pltf's Reply to Response to Motion to Produce, filed Jul. 12, 1965.
- July 16 33. Docket Pltf's Memorandum of Points and Authorities in Opposition to Motion to Strike Motion for Production of Documents, filed Jul. 12, 1965.
- July 16 34. Docket Defts' Revised Statement of Facts, filed July 12, 1965.
- July 16 35. Docket Pltf's Memorandum in Support of Motion to Reopen Hearing on Appl. for Interlocutory Injunction, filed July 12, 1965.
- July 16 36. Docket Pltf's Certificate of Service, filed July 12, 1965.
- July 16 37. Docket Order on Motions Presented July 12, 1965 and filed July 13, 1965 at San Francisco, Calif., allowing pltf. to file its amended and supplemental complaint within 30 days, allowing defts. 30 days from receipt of copy thereof to serve and file any motion or other responsive matter, placing Defts' Motion to Dismiss Complaint and Pltf's Motion for Reopening Hearing on Preliminary Injunction and for Additional Relief Pendente Lite both off calendar without prejudice to apply for reinstatement and consideration. Date Order or Judgment Noted, WCMathes

DATE**PROCEEDINGS****1965**

- Aug. 12 38. File Plt's Amended and Supplemental Complaint for injunction.
- Aug. 13 39. File Plt's Certificate of service of the amended and supplemental complaint for injunction upon the defts.
- Aug. 25 40. File Plt's Notice of taking deposition of Arthur W. Saffert.
- Sept. 1 41. File Defts' Notice of submission of their motion and request to the Clerk to submit.
- Sept. 1 42. File ANSWER of defendants to amended and supplemental complaint.
- Sept. 1 43. File Defts' Motion for Judgment on the pleadings, or in the alternative, for Summary Judgment.
- Sept. 1 x44. File Defts' Memorandum in support of motion for judgment etc.
- Sept. 1 45. File Defts' Motion for Protective Order.
- Sept. 14 46. File Response of Securities and Exchange Commission to Defendants' Motion for Protective Order.
- Sept. 14 47. File Motion of Securities and Exchange Commission for Permission to Amend Complaint to Add Parties Defendant, with proposed Second Amended and Supplemental Complaint for Injunction and Affidavit of W.S. Tucker attached.
- Sept. 14 48. File Plaintiff's Memorandum on Motion to Amend to Add Parties Defendant.
- Sept. 14 49. File Certificate of Mailing (of documents filed Sept. 14, 1965)
- Sept. 14 50. File Response of Defts. to Motion to Amend by Adding Additional Parties.

DATE**PROCEEDINGS****1965**

- Sept. 21 51. File Affidavit of W. Stevens Tucker re deposition of A. W. Saffert.
- Sept. 24 52. File Reporter's Transcript of Proceedings Re: Deposition of Arthur W. Saffert.
- Oct. 26 53. File Third Affidavit of W. Stevens Tucker, atty. for pltf., in response to certain portions of the Commission's Motion for Production of Documents.
- Oct. 26 x54. File Pltf's Memorandum in opposition to defts' Motions for Judgment on the pleadings or in the alternative for Summary Judgment and for a Protective order and in support of pltf's Motion to amend complaint to add parties deft.
- Oct. 28 55. File Pltf's Certificate of mailing.
- Oct. 28 56. File Pltf's Errata Sheet to Memorandum in opposition to defts' Motions for Judgment on the pleadings etc.

1966

- Feb. 14 57. Enter and File Order that defts' motion for a protective order to prevent the taking of a deposition of deft Arthur W. Saffert is hereby granted; it is further ordered that the Clerk promptly serve copies of this order upon the parties appearing in this cause. Date Order or Judgment Noted, WCMathes
- Feb. 14 58. Enter and File Order that pltf's motion to add additional parties deft is hereby denied; that the Clerk serve copies of this order upon the parties. Date Order or Judgment Noted, WCM
- [4]
- Feb. 14 59. Enter and File Order that defts' motion for judgment on the pleadings is hereby granted; that defts serve and lodge with the Clerk,

DATE

PROCEEDINGS

1966

- Feb. 14 59. within 10 days from the date of this order,
(Continued) an appropriate form of judgment, which shall provide that pltf's action be dismissed without costs to any party, and that the judgment shall not constitute an adjudication upon the merits; that the Clerk promptly serve copies of this order upon the attys for the parties appearing in this cause. Date Order or Judgment Noted, 2-14-66; WCMathes
- Feb. 14 — Copy of each of above orders mailed to counsel for both sides.
- Feb. 16 60. File Defts' Notice of lodging proposed judgment with certificate of mailing.
- Feb. 16 — Lodge proposed judgment.
- Mar. 23 61. Enter and file judgment that Defendant's Motion for Judgment on the Pleadings be and the same is granted, each party to bear its own costs; and adjudging that this judgment shall not constitute an adjudication upon the merits. Date Order or Judgment Noted, WCMathes; 3-23-66
- Mar. 23 Conformed copy of judgment mailed to Mr. Tucker and to Mr. Frank.
- Apr. 27 62. File Pltf's Notice of Appeal, with affidavit of service on counsel.
- May 9 63. File Designation of record on appeal.
- June 3 64. Enter and File Order that the record on appeal time is hereby extended to and including July 2, 1966. Date Order or Judgment Noted, CAM
- July 1 65. Enter and file Order Extending Time to file record and docket appeal to and including July 26, 1966. Date Order or Judgment Noted, WEC

[Filed March 30, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. Civ-5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRET, JOSEPH B. SETTER, BREEFERD W. LARGE, JR., RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM A. REEDY, BONNIE B. BILBREY, PRODUCERS LIFE INSURANCE COMPANY, a corporation, and PRODUCERS THRIFT & LOAN COMPANY, a corporation, DEFENDANTS

COMPLAINT FOR INJUNCTION

I

1. It appears to the Securities and Exchange Commission, plaintiff herein, that the defendants National Securities, Inc., a corporation ("National Securities"), National Life & Casualty Insurance Company, a corporation ("National Life"), Robert H. Wallace ("Wallace"), Robert C. Bohannon, Jr. ("Bohannon"), Ted Wilkins ("Wilkins"), John S. Barret ("Barret"), Joseph B. Setter ("Setter"), Breeferd W. Large, Jr. ("Large"), Richard G. Johnson ("Johnson"), Ernest A. Richards ("Richards"), William A. Reedy ("Reedy"), Bonnie B. Bilbrey ("Bilbrey"), Arthur W. Saffert, ("Saffert"), Producers Life Insurance Company ("Producers Life"), a corpora-

tion, and Producers Thrift & Loan Company ("Producers Thrift"), a corporation, have been and are engaged and are about to engage in acts and practices which constitute violations of Section 10(b) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5.

2. This action arises under Section 21(e) of the Act, 15 U.S.C. 78(e).

3. This Court has jurisdiction of this action under Section 27 of the Act, 15 U.S.C. 78aa.

II

1. The defendant National Life is an Arizona corporation engaged in the life insurance business in Arizona and other western states.

2. The defendant National Securities is a Colorado corporation transacting business in Arizona as a holding company owning a majority of and controlling interest in the stock of National Life.

3. At all times material hereto, the defendant Wallace has been president, chief executive officer and a director of National Securities and National Life; the defendant Bohannon has been executive vice-president of National Securities and National Life; the defendant Saffert has been employed by National Life as an actuary by National Life; and the defendants Wilkins, Barret, Setter and Large were employees of National Securities, or of National Life or of another subsidiary of National Securities, and subject to the direction and control of the defendant Wallace as principal executive officer of National Life and National Securities.

4. The defendant Producers Life is an Arizona corporation engaged in the life insurance business in Arizona and other western states.

5. The defendants Johnson, Reedy, Richards, Billbrey, prior to and on April 27, 1964, controlled and managed the business and affairs of Producers Life and, together with J. Grant Iverson, Jess E. Hunter and John J. Falcomer, comprised its board of directors.

6. As of April 27, 1964, Producers Life had approximately 14,000 stockholders and 880,000 shares of common

stock issued and outstanding, including 50,205 treasury shares.

7. Prior to and on April 27, 1964, the defendants Johnson, Richards, Reedy and Bilbrey owned 27,415 shares of Producers Life and, in addition, controlled 35,904 shares of Producers Life which were held in the name of Producers Thrift, all of whose stock was owned by said defendants and one other person.

8. Prior to and on April 27, 1964, the defendants Johnson, Richards and Reedy held voting proxies representing approximately 565,000 out of approximately 880,000 shares of the outstanding common stock of Producers Life.

III

1. Prior to March 15, 1964, and continuing to the present time, the defendants have been and are making use of means and instrumentalities of interstate commerce and of the mails to engage in manipulative and deceptive devices and contrivances, in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j, and Rule 10b-5 thereunder, 17 CFR 240.10b-5; in connection with the purchase and sale of securities issued and to be issued by Producers Life and National Life, a) by employing a device, scheme and artifice to defraud; b) by making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; and c) by engaging in acts, practices and a course of business which operates and would operate as a fraud and deceit upon the defendant Producers Life and its stockholders, as more fully set forth below.

2. Prior to March 15, 1964, and continuing until the present time, in derogation of the rights and interests of the stockholders of Producers Life, and in contravention of the fiduciary obligations of the defendants Johnson, Richards, Bilbrey and Reedy ("selling directors") to Producers Life and its stockholders, and contrary to the fiduciary obligations of the defendants Wallace, Saffert, Wilkins, Barret, and Large ("successor directors") to

Producers Life and its stockholders, the defendants with the objective of transferring control of and dominion over the assets, business (including insurance in force) and other resources of Producers Life to National Life and National Securities, and with the ultimate objective of accomplishing the merger, consolidation or amalgamation of Producers Life and National Life (with Producers Life to remain as the surviving corporation under the name National Producers Life Insurance Company, subject to the dominion and control of the defendant National Securities and its nominees), have conducted negotiations and effected arrangements including the following:

- (a) the sale and transfer of the stock of Producers Life owned by Messrs. Johnson, Richards, Reedy and Bilbrey ("the selling directors"), by Producers Thrift and by Producers Life ("treasury stock") to National Life or National Securities;
- (b) the sale, surrender and transfer by defendants Johnson, Richards, Bilbrey and Reedy to National Life or National Securities and their designees of their directorships and offices in Producers Life, together with the voting proxies of ordinary stockholders held by them;
- (c) the acquisition by defendant Reedy and his nominees from Producers Life of 111,088 shares of the Class A stock and 1,469 shares of the Class B stock of Dependable Life Insurance Company ("Dependable") owned by Producers Life;
- (d) the acquisition by Producers Thrift of 40,000 shares of its preferred stock, \$100,479 of its promissory notes and assigned collateral and 25,248 shares of the stock of Producers Finance Company of Arizona owned by Producers Life;
- (e) the execution of agreements under which the selling directors are to receive \$979,000 from National Securities for their agreements not to compete in the insurance business and the assumption by National Securities of pre-existing obligations of Producers Life to certain other persons under similar agreements; and

(f) the consolidation of all of the business operations of Producers Life into those of National Life; and the defendants are seeking to accomplish the following additional elements of their scheme and plan:

- (g) the merger or consolidation of Producers Life and National Life by means of purchases and sales of securities through an agreement of consolidation and plan of reorganization;
- (h) the acquisition of complete dominion over and control by National Life and National Securities, their officers, directors and nominees, of all assets, business and affairs of Producers Life.

3. On or about April 27, 1964, the individual defendants in their respective capacities as directors of National Securities, of Producers Life, of Dependable Life and of Producers Thrift met in Phoenix, Arizona, to authorize the corporate actions necessary to put the foregoing plan and scheme into operation.

4. On or about April 27, 1964, pursuant to actions taken by their directors, the corporate defendants National Life, National Securities, Producers Life and Producers Thrift and the individual defendants Johnson, Richards, Reedy and Bilbrey entered into and performed an escrow agreement which, by means of the documents, moneys and securities passing through said escrow, accomplished the purposes of Items (a), (b), (c), (d) and (e) of paragraph 2 hereof.

5. The defendants Reedy, Johnson, Bilbrey and Richards, in furtherance of the plan and scheme, caused Producers Life to transfer to National Securities through said escrow 50,203 shares of the treasury stock of Producers Life for a stated consideration of \$114,964.87 in cash or securities (equivalent to \$2.29 per share, the then book-value of said stock) at a time when the market price for said stock on the over-the-counter market was approximately 7½ bid, 8 asked.

6. On or about April 27, 1964, National Securities purported to assume certain obligations of Producers Life and Dependable in favor of persons named Pound, Love-

lace, Heeder and Davis in the amount of \$627,891.28 as an additional consideration for the purchase of the 50,208 shares of Producers Life as described in paragraph 5 hereof. It was intended, however, that, after assuming dominion over and control of Producers Life, National Securities and National Life, through their agents and nominees, would cause Producers Life or the surviving corporation resulting from the prospective merger or consolidation of Producers Life and National Life to reimburse National Securities for moneys paid out pursuant to its assumption of such obligations.

7. On or about April 27, 1964, as an incident of the escrow described in paragraph 4 hereof, and in furtherance of defendants' plan and scheme, National Securities, Inc. and the selling directors executed and exchanged agreements by which the selling directors and Dependable agreed (with some limitations) not to compete in the insurance business with Producers Life and National Life or any entity emerging from the prospective merger or consolidation of those corporate defendants, and National Securities agreed to compensate the selling directors in an aggregate amount of \$979,000 payable in 120 monthly installments following April 30, 1964. As an element of said scheme and plan, it was intended that after assuming dominion over and control of Producers Life, National Securities and National Life, through their agents and nominees, would cause Producers Life, or the corporation surviving from said merger or consolidation, to reimburse National Securities for moneys paid out pursuant to said "non-compete" agreements.

8. On or about April 27, 1964, in furtherance of said scheme and plan, the defendants Johnson, Reedy, Richards and Bilbrey received approximately \$570,000 from National Securities through said escrow as consideration for their 27,416 shares of the stock of Producers Life, which sum is equivalent to \$20.79 per share.

9. On or about April 27, 1964, in furtherance of said scheme and plan, the selling directors caused Producers Thrift, which they owned and controlled, to sell through said escrow to National Securities 38,894 shares of the stock of Producers Life for an aggregate consideration of \$372,769.41, or approximately \$9.00 per share.

10. On or about April 27, 1964, in furtherance of said scheme and plan, at a meeting of the directors of Producers Life, the selling directors resigned their positions as officers and directors of Producers Life, one by one, and caused the remaining directors to elect in their stead as directors, nominees of National Securities and National Life, namely, the defendants Saffert, Barret, Setter and Large, who thereupon assumed management and control of the assets, business and affairs of Producers Life.

11. On or about April 27, 1964, in furtherance of said plan and scheme, the defendants Saffert, Barret, Setter and Large, then constituting a majority of the board of directors of Producers Life (called the "new board"), forthwith caused the election of defendant Saffert as president and of defendant Large as secretary of said corporation.

12. On or about April 27, 1964, in order to cement the dominion and control over Producers Life by National Securities and National Life, and their agents and nominees, and in furtherance of said scheme and plan, the defendants Johnson, Edwards and Reedy transferred through said escrow to the defendant Wallace voting proxies representing in excess of 60 per cent of the then outstanding stock of Producers Life, together with documents of assignment and substitution.

13. On April 27, 1964, as a further incident of said scheme and plan, the new board of directors of Producers Life forthwith caused its officers Saffert and Large to execute a "Management Agreement" between Producers Life, National Securities by which National Securities assumed full and complete management of the business and affairs of Producers Life.

14. Shortly after April 27, 1964, all of the books, records and business operations of Producers Life were removed to the premises of National Life and blended into the operations of National Life, the offices of Producers Life were closed and its affairs since have been conducted in the office of National Life.

15. Shortly after April 27, 1964, the minority directors of Producers Life, that is, Messrs. Iverson, Falconer and Hunter, resigned. The remaining directors elected

the defendants Wallace, Wilkins and Large; nominees of National Securities, in their stead. This board then elected defendant Bohannon as assistant secretary of Producers Life with specific powers respecting transactions in the stocks, bonds and other securities in its securities portfolio.

16. Subsequent to April 27, 1964, the shares of Producers Life acquired by National Securities were transferred to National Life.

17. On or about November 27, 1964, in furtherance of said scheme and plan, the defendants National Life and Producers Life entered into an agreement to consolidate and reorganize. This agreement was authorized on behalf of Producers Life by its Board of Directors, all of whom were nominees of National Securities. The agreement provides, *inter alia*, for the merger of National Life into Producers, the termination of the management agreement (described in paragraph 18 hereof), a reorganization of Producers Life and the issuance of shares of Producers Life in exchange for outstanding shares of National Life, the change of the name of Producers Life to National Producers Life Insurance Company (National Producers), and an undertaking by Producers Life and National Life that National Producers will reimburse National Securities for all expenses arising from National's obligations (a) pursuant to the "non-compete" agreements executed in favor of defendants Bilbrey, Johnson, Richards and Reedy as described in paragraph 7 hereof, and (b) pursuant to its obligations to persons named Pound, Lovelace, Heeder and Davis as described in paragraph 6 herein. In addition, the agreement to consolidate and reorganize provides for its submission to the stockholders of Producers Life and National Life for their approval.

18. On or about November 27, 1964, in furtherance of said scheme and plan, the defendants mailed to the stockholders of Producers Life copies of the consolidation agreement dated November 27, 1964, together with copies of the notice of special meeting of stockholders to be held on December 31, 1964, and other material soliciting proxies to the defendants Saffert and Wallace to be voted in favor of the consolidation agreement. The consolidation

agreement provides that Producers Life (to be renamed National Producers Life Insurance Company), as the surviving corporation upon consummation of the agreement, is to reimburse National Securities (and charge to expense) any sums paid by National Securities on account of its "non-compete" agreements of April 27, 1964, with the selling directors, but neither in such proxy solicitation material nor otherwise have the defendants disclosed to stockholders of Producers Life that the amounts to be paid to National Securities are about \$97,900 per year; that, in addition, the consolidation agreement provides that the surviving corporation will reimburse National Securities (and charge as expense) any sums paid out by National Securities by reason of its assumption on April 27, 1964, of certain liabilities of Producers Life to Pound, Lovelace, Heeder and Davis for their agreements not to compete in the insurance business, but the defendants have not disclosed to stockholders of Producers Life in such proxy solicitation material or otherwise that the amount so to be paid is approximately \$113,000 per year, that the "non-compete" agreements between National Securities and the selling directors run for the period of 10 years from April 30, 1964, that the "non-compete" agreements between Producers Life and Pound, Lovelace, Heeder and Davis, which were assumed by National Securities on April 27, 1964, run for five years from December 31, 1964, and that under the consolidation agreement National Securities would relieve itself from, and transfer to the survivor of the proposed consolidation of Producers Life and National Life, its obligations to Pound, Lovelace, Heeder and Davis which it had purported to assume and for which it was credited in the amount of \$627,891.76 on the stated purchase price of \$742,850.63 for the 50,203 shares of stock of Producers Life as described in paragraphs 5 and 6 hereof.

19. The meeting so noticed was convened on December 31, 1964, but was recessed *sine diem* without a vote on the proposed merger.

20. In furtherance of said scheme and plan, the defendants National Securities and National Life, Wallace and Bohannon, acting through the defendants Saffert and

Large, as their agents and nominees, arranged for the meeting of stockholders of Producers Life so recessed on December 31, 1964, to be reconvened on March 26, 1965, in Phoenix, Arizona. On March 13, 1965, said defendants caused a notice of the reconvening of the meeting to be sent (over the signature of the defendant Large) to stockholders of Producers Life with an enclosed communication (over the signature of the defendant Saffert) soliciting proxies in favor of the existing management to be voted in favor of the consolidation agreement and plan of reorganization described in paragraph 17 hereof.

21. On or about March 2, 1965, in furtherance of said scheme and plan, the defendant National Securities, National Life, Wallace, Bohannon, Saffert and Large and the defendant directors of Producers Life caused to be mailed to stockholders of Producers Life a communication (over the signature of the defendant Saffert) soliciting proxies to be voted in favor of the proposed agreement and plan of reorganization with which was enclosed a copy of an investment advisory letter entitled "North's News Letter and Special Report" dated February 9, 1964. Said "Special Report" while purporting to be an analysis by an independent investment advisory service of the financial affairs of National Securities and its subsidiaries, including National Life and Producers Life, and of the effect of the proposed merger and consolidation, in fact represented nothing more than as assemblage of statistics and projections which had been received from the management of National Securities (including management's forecast of \$460,000 net income for the two insurance companies to be merged for the calendar year 1965, purportedly based upon financial statements as of December 31, 1963, and June 30, 1964), and said "Special Report" did not in any true sense represent an independent analysis of National Securities by the advisory service.

22. In furtherance of said scheme and plan, the communications sent out on March 13, 1965 and March 2, 1965 as described in paragraphs 21 and 22 hereof, omitted to set forth the following material facts necessary in order to make the statements made therein not misleading;

- (a) that during the fiscal year ending December 31, 1964, a net operating loss of \$35,657 had been sustained by National Life and a net operating loss of \$69,716 had been sustained by Producers Life;
- (b) the shares of capital stock of Producers Life acquired by National Life at a stated cost in excess of \$1,200,000 had been written down on the books of National Life to \$641,658, the approximate market value of said stock as of December 31, 1964, with a resulting reduction of the surplus account of National Life in the sum of \$579,381.15.

The defendants, unless restrained and enjoined, will continue to engage in the acts and practices specified above.

WHEREFORE, the Securities and Exchange Commission demands a temporary restraining order, a preliminary injunction and a permanent injunction restraining and enjoining the defendants National Securities, Inc., National Life & Casualty Insurance Company, Robert H. Wallace, Robert C. Bohannon, Jr., Ted Wilkins, John S. Barret, Joseph B. Setter, Breeferd W. Large, Jr., Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey, Arthur W. Saffert, Producers Life Insurance Company and Producers Thrift & Loan Company, their officers, agents, employees, attorneys, successors or assigns, and all persons acting in concert or participation with them, from, directly or indirectly—

A. making use of any means or instrumentality of interstate commerce or of the mails to engage in any manipulative or deceptive device or contrivance, in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, in connection with the purchase or sale of securities issued or to be issued by Producers Life or National Life or National Securities, or any affiliate or subsidiary of any of such issuers, involving any plan or

arrangement between the managing directors of Producers Life and the managing directors of National Securities or National Life to surrender and transfer to National Life the directorships or offices of the managing directors of Producers Life, together with voting proxies sufficient to ensure dominion over and control of Producers Life by National Life and National Securities, or the ultimate merger, consolidation or amalgamation of Producers Life and National Life, in derogation of the rights and interests of the stockholders of Producers Life and in contravention of the fiduciary obligations of the defendants or any of them to Producers Life and its stockholders, a) by employing any device, scheme or artifice to defraud; b) by making any untrue statement of material fact or omitting to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or c) by engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon Producers Life or its stockholders, whether through—

- (1) the device of a plan of reorganization, consolidation, merger or otherwise, and specifically through implementation or consummation of the Consolidation Agreement and Plan of Reorganization executed by Producers Life Insurance Company, National Life Insurance Company and National Securities, Inc., dated November 27, 1964; or
- (2) the solicitation of proxies or votes of stockholders to be used to accomplish any such plan of reorganization, consolidation or merger; or
- (3) any untrue statement of material fact or omission to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made not misleading, with respect to:

- (a) the dollar amount of any liabilities or obligations assumed or to be assumed by Producers Life or the surviving company in any merger involving Producers Life;

- (b) the assets, liabilities, capital, surplus or deficit, income or losses of Producers Life or National Life or of any other company with which it may be proposed to merge or combine Producers Life;
- (c) any transaction which materially affects the assets, liabilities, capital surplus or deficit, income or losses of Producers Life, National Life, or of any other company in which it may be proposed to merge, combine or consolidate Producers Life; or
- (d) any forecast as to the earnings, income or amount of business of Producers Life, National Life or of any surviving company into which Producers Life may be merged, combined or consolidated;

or engaging in any act, practice or course of business of similar object or purport; or

B. voting or causing to be voted any proxies executed by stockholders of Producers Life which have been received by the defendant Wallace from the defendants Johnson, Richards or Reedy;

C. voting any proxies executed by stockholders of Producers Life appointing the defendants Saffert and Wallace, or either of them, which were solicited or received subsequent to April 27, 1964;

D. voting any of the 135,008 shares of stock of Producers Life held by National Life as of December 31, 1964;

E. performing any act which facilitates or is designed to facilitate the consummation of the Consolidation Agreement and Plan of Reorganization dated November 27, 1964, between Producers Life, National Life, and National Securities.

The Securities and Exchange Commission demands such other and further relief that may be appropriate, just and equitable, or necessary to effectuate and implement

the terms of any decree that may be entered by the Court in accordance with the foregoing demands.

/s/ Arthur E. Pennekamp
ARTHUR E. PENNEKAMP
Regional Administrator

/s/ F. E. Kennamer, Jr.
F. E. KENNAMER, JR.
Assistant General Counsel

/s/ W. Stevens Tucker
W. STEVENS TUCKER
Assistant Regional Administrator

/s/ William M. Ziering
WILLIAM M. ZIERING
Attorney
Securities and Exchange Commission

25
[Filed March 30, 1965]

**UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)**

Civil Action No. Civ-5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

**NATIONAL SECURITIES, INC., a corporation, NATIONAL
LIFE & CASUALTY INSURANCE COMPANY, a corporation,
ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR.,
ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRET,
JOSEPH B. SETTER, BREEFERD W. LARGE, JR., RICHARD
G. JOHNSON, ERNEST A. RICHARDS, WILLIAM A.
REEDY, BONNIE B. BILBNEY, PRODUCERS LIFE INSUR-
ANCE COMPANY, a corporation, and PRODUCERS THRIFT
& LOAN COMPANY, a corporation, DEFENDANTS**

**MOTION OF SECURITIES AND EXCHANGE
COMMISSION FOR TEMPORARY RESTRAINING
ORDER AND PRELIMINARY INJUNCTION**

The Securities and Exchange Commission, plaintiff herein, moves this Honorable Court to enter a Temporary Restraining Order and a Preliminary Injunction in accordance with the demand made in the Complaint for Injunction filed herein.

This motion is based upon the Complaint for Injunction and the Affidavit W. Stevens Tucker, Assistant Regional Administrator, of the San Francisco Regional Office of the Securities and Exchange Commission, filed herein showing that the defendants National Securities, Inc., National Life & Casualty Insurance Company, Robert

B. Wallace, Robert C. Bohannon, Jr., Arthur W. Saffert, Ted Wilkins, John S. Barret, Joseph B. Setter, Breeferd W. Large, J., Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey, Producers Life Insurance Company and Producers Thrift & Loan Company have been and are engaged in acts and practices in violation of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)), and Rule 10b-5 (17 CFR 240.10b-5) thereunder, and that said defendants, unless enjoined, will continue to engage in such acts and practices contrary to the public interest and to the serious prejudice of Producers Life Insurance Company and its stockholders.

Respectfully submitted,

ARTHUR E. PENNEKAMP
Regional Administrator
F. E. KENNAMER, JR.
Assistant General Counsel
W. STEVENS TUCKER
Assistant Regional Administrator
WILLIAM M. ZIERING
Attorney
Attorneys for the Securities and
Exchange Commission

By /s/ W. Stevens Tucker
W. STEVENS TUCKER
Of Counsel for Securities and
Exchange Commission

[Filed March 30, 1965]

**Affidavit of W. Stevens Tucker in Support of Motion for
Temporary Restraining Order and Preliminary Injunction**

[9] 25. An additional communication soliciting proxies and advocating approval of the merger was caused to be sent through the mails by the management of Producers Life over the purported signature of A. W. Saffert, President, on or about the 2d of March 1964, enclosing a copy of a document entitled "North's News Letter Report" dated February 9, 1965, described as "a leading independent financial reporting service with a wide national following" copies of which communication and report are attached respectively, as Exhibits 12A and 12B. Said report, Exhibit 12B, purports to be based on information supplied by the management of Producers Life, including financial information as of June 30, 1964 and December 31, 1963.

[10] 26. In compiling and transmitting said letter of March 2, 1964, and enclosure (Exhibits 12A and 12B) the management of Producers Life and A. W. Saffert, its president, omitted to disclose to stockholders of Producers Life that preliminary financial statements, including statements of operations for the year ending December 31, 1964, had been prepared some time prior to February 18, 1965 by and for National Life and by and for Producers Life. They further omitted to disclose that these financial statements, including statements of operation, reflected a net operating loss of \$35,657 by National Life and a net operating loss of \$69,716 by Producers Life for the year 1964. They also failed to disclose that a formal annual statement of the financial condition and operations of National Life for the year ending December 31, 1964, had been sworn to by R. M. Wallace as President, George B. Sharp as Secretary and Arthur W. Saffert as Actuary on February 26, 1965 and filed with the Insurance Commissioner of Nevada on March 1, 1965 and that this annual statement also reflected the net operating loss of \$35,657. The annual report of Producers Life for the year 1964 had not been filed by 2 P.M. March 26, 1965

with the Insurance Commissioner of the State of Arizona and at 3:30 P.M. on March 29, 1965 (the time of execution of this affidavit) it had not been filed with the Insurance Commissioner of the State of Nevada.

27. The Consolidation Agreement (Exhibit 9) and the material dated November 27, 1964 accompanying its transmittal to stockholders dated March 2, 1965 (Exhibits 12A and 12B) all fail to disclose that the amounts payable to National Securities by Producers Life under the provisions of paragraph 24 of the Consolidation Agreement (Exhibit 9) would amount to \$8,157 per month (equivalent to \$97,884 per year) from gross revenues (on account of the payments required to be made to [11] Messrs. Johnson, Richards, Reedy and Bilbrey) for the remainder of the period of 120 months after April 30, 1964, and further fail to disclose the additional substantial amounts that would become payable by Producers Life to National Securities from gross revenues to reimburse National Securities for payments to be made to the persons named Pound, Lovelace, Heeder and Davis pursuant to National Securities undertaking in Exhibit 4 (for which it had received credit in the sum of \$635,884.81 on account of its purchase price in acquiring the 50,203 shares of treasury stock of Producers Life).

28. The annual report of Producers Life for the year ending December 31, 1964 was filed with the Insurance Commissioner of the State of Louisiana on March 1, 1965 and an amended report was filed with such Commissioner on March 15, 1965, both of which show a loss from operations for the year 1964 of \$69,716, but such loss was not disclosed to stockholders in any communications sent to stockholders of Producers Life by its officers and directors.

29. The North's News Letter Report Exhibit 12B was represented in the transmittal letter Exhibit 12A to be the report of "a leading independent financial service". It was not disclosed to Producers Life stockholders that: (a) the Report was based entirely upon information supplied to the editor and publisher of the service by defendants Wallace and Bohannon and certain of their assistants, including the document (and included financial statements and estimates) appended hereto as Exhibit 10,

(b) that copies of the Management Agreement (Exhibit 8) and Consolidation Agreement (Exhibit 9) were not submitted by them to the editor for his independent consideration, (c) that he relied on their estimates of the unrealized appreciation on lands (reflected in the balance sheets in Exhibit 10), that they furnished the valuation formulas applied in the next to the last paragraph on page 2 of the Report (Exhibit 12B) and the editor merely made the mathematical computations involved in applying the formulas to the figures in the financial statements, estimates and forecasts supplied by the management in Exhibit 10.

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**Excerpts From Exhibits Included in Affidavit of
W. Stevens Tucker**

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**Excerpt From Minutes of Special Meeting of Board of
Directors of Producers Life Insurance Company,
Monday, April 27, 1964**

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[4] Mr. Johnson then invited Mr. Wallace, to outline for the benefit of the Board the plans which National Securities, Inc., had in mind for the future growth and development of Producers. Mr. Wallace reminded all present that National Securities, Inc., was in fact a holding company and [5] engaged in business as such. He stated that because of the future of National's business it had effective control over subsidiaries many of which are in one form or another engaged in the insurance business and he felt that it was quite clear to any person familiar with the internal operations of a life insurance company that by management of the affairs of Producers, National Securities would be able to perform for Producers all of the services the latter required and effect economics of a magnitude which companies of the size and with the scope of operations of Producers were, generally speaking, unable to effect themselves. This, he noted, required a careful coordination of the home office

affairs and procedures of Producers with those of National Life and Casualty Insurance Company, a subsidiary of National Securities. He said that he envisioned, if the Board of Directors of Producers approved this transaction, that the needed home office personnel, equipment, supplies, and procedures of Producers would be transferred to the home office of National Securities and carefully blended in with the operations of National and its subsidiaries to the end that efficiencies be achieved without sacrificing the separate corporate identity of Producers. He discussed in detail the economies which he felt would be possible.

He noted further that it was the intent of National Securities that subsequently one form or another of corporate reorganization or amalgamation be proposed to the stockholders of Producers. He stated that at the present time he felt it was not particularly important to determine precisely the method to be chosen so long as it was clear that the stockholders of Producers would, at the appropriate time, have proposed to them a specific plan or reorganization as a result of which they would formally join the National Securities group, and be offered the opportunity to convert their present holdings to shares of the Common Stock of National Securities. Substantial discussion ensued during which the directors put questions to Mr. Wallace and Mr. Wallace answered all questions asked of him.

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PRODUCERS LIFE INSURANCE COMPANY

Flow Chart of Escrow—April 27, 1964

Item	National Securities		Former Principals		Producers Life		Producers Thrift & Loan		Dependable Life
	Due From	Due To	Due From	Due To	Due From	Due To	Due From	Due To	
1. Cashiers check—\$360,000.00	\$ 360,000.00	\$ 912.05	\$	\$330,000.00	\$	\$	\$	\$ 29,087.95	\$
2. Shares of Producers Life									
27,416 a.		570,000.00	570,000.00						
33,984 a.		372,769.41					372,769.41		
3. Notes by National Securities	583,681.46			240,000.00				843,681.46	
d. Note to Reedy			70,000.00			70,000.00			
e. Note to Producers Thrift						843,681.46	343,681.46		
4 a. 40,000 a. Producers Thrift Pfd.					200,667.00			200,667.00	
b-g. Collateral Notes & Assignments					100,479.00			100,479.00	
h. 25,248 a. Producers of Arizona					42,535.46			42,535.46	
5. Shares of Dependable Life									
a. 90,009 Class A				170,000.00	170,000.00				
b. 11,966 Class A					22,616.25				
c. 9,113 Class A)					20,000.00				
d. 1,469 Class B)									
6 a-b. Cash						42,616.25			20,000.00
c-d. Note and assignment—Reedy			100,000.00			100,000.00			
e. Note from Item 3(d)—Reedy			(above)			(above)			
7. 13,588 a. Producers Finance Utah					13,588.00				13,588.00
8. Cash						13,588.00			
9. Producers Life Treasury Stock		742,856.63			742,856.63				
11. (Assumption) Agreement	627,891.76					627,891.76			
17. Note	114,964.87					114,964.87			
	<u>\$1,686,538.09</u>	<u>\$1,686,538.09</u>	<u>\$740,000.00</u>	<u>\$740,000.00</u>	<u>\$1,312,742.34</u>	<u>\$1,312,742.34</u>	<u>\$716,450.87</u>	<u>\$716,450.87</u>	<u>\$33,588.00</u>
Cash or equivalent	\$ 360,000.00	\$ 912.05	\$ 70,000.00	\$ 570,000.00	\$	\$ 56,204.25	\$343,681.46	\$372,769.41	\$33,588.00
Securities	\$ 698,646.33	\$1,685,626.04	\$570,000.00	\$170,000.00	\$1,312,742.34	\$ 528,646.33	\$372,769.41	\$343,681.46	
Other	\$ 627,891.76		\$100,000.00			727,891.76			
	<u>\$1,686,538.09</u>	<u>\$1,686,538.09</u>	<u>\$740,000.00</u>	<u>\$740,000.00</u>	<u>\$1,312,742.34</u>	<u>\$1,312,742.34</u>	<u>\$716,450.87</u>	<u>\$716,450.87</u>	<u>\$33,588.00</u>
						\$ 528,646.33			
						170,000.00			
						\$ 698,646.33			
						4,007.83			
						\$ 694,638.50			

27, 1984

National Securities		Former Principals		Producers Life		Producers Thrift & Loan		Dependable Life		Producers Finance of Utah	
Due From	Due To	Due From	Due To	Due From	Due To	Due From	Due To	Due From	Due To	Due From	Due To
\$ 860,000.00	\$ 912.05	\$	\$880,000.00	\$	\$	\$	\$ 29,087.95	\$	\$	\$	\$
	570,000.00	570,000.00				372,769.41					
	872,769.41										
583,681.46		70,000.00	240,000.00		70,000.00	343,681.46	843,681.46				
					343,681.46						
				200,667.00			200,667.00				
				100,479.00			100,479.00				
				42,535.46			42,535.46				
			170,000.00	170,000.00							
				22,616.25							22,616.25
				20,000.00					20,000.00		
		100,000.00 (above)			42,616.25			20,000.00		22,616.25	
				13,588.00					13,588.00		
	742,856.63			742,856.63							
627,891.76					627,891.76						
114,964.87					114,964.87						
\$1,686,538.09	\$1,686,538.09	\$740,000.00	\$740,000.00	\$1,312,742.34	\$1,312,742.34	\$716,450.87	\$716,450.87	\$33,588.00	\$33,588.00	\$22,616.25	\$22,616.25
\$ 860,000.00	\$ 912.05	\$ 70,000.00	\$570,000.00	\$	\$ 56,204.25	\$343,681.46	\$872,769.41	\$33,588.00		\$22,616.25	
\$ 698,646.33	\$1,686,526.04	\$570,000.00	\$170,000.00	\$1,312,742.34	\$ 528,646.33	\$372,769.41	\$343,681.46	\$33,588.00			\$22,616.25
\$ 627,891.76		\$100,000.00			727,891.76						
\$1,686,538.09	\$1,686,538.09	\$740,000.00	\$740,000.00	\$1,312,742.34	\$1,312,742.34	\$716,450.87	\$716,450.87	\$33,588.00	\$33,588.00	\$22,616.25	\$22,616.25
	Securities, per above				\$ 528,646.33						
	Cash out of escrow				170,000.00						
					\$ 698,646.33						
	Cash to Producers Life				4,007.83						
	Marketable securities to Producers Life				\$ 694,638.50						

1987: 121-122

[illegible]

EXHIBIT 8

MANAGEMENT AGREEMENT
BY AND BETWEEN
NATIONAL SECURITIES, INC.
AND
PRODUCERS LIFE INSURANCE COMPANY

[1] WITNESS the terms of this agreement made and entered into by and between NATIONAL SECURITIES, INC., a corporation (hereinafter referred to as "National"), and PRODUCERS LIFE INSURANCE COMPANY, a corporation organized and existing under and by virtue of the laws of the State of Arizona (hereinafter referred to as "Producers"), this 30th day of April, 1964.

WHEREAS, The Board of Directors of Producers is composed of persons affiliated with National and its subsidiaries; and

WHEREAS, National through its subsidiaries is the owner of such physical plant and facilities and an employer of such experienced personnel as may be gainfully employed to manage the affairs of Producers; and

WHEREAS, National and Producers each desire at some future date and during the term of this agreement to propose to the appropriate stockholders a corporate reorganization or amalgamation wherein and whereby National directly, or indirectly through its subsidiaries now or hereafter existing, shall acquire ownership of all the assets and assume all the liabilities of Producers; and

WHEREAS, the Board of Directors of each party hereto believes that it is in the best interests of the stockholders of each of the parties hereto and the policyholders of Producers that prior to any such corporate amalgamation or reorganization as aforesaid National shall manage the affairs of Producers, subject to the supervision of the Board of Directors of the latter;

NOW, THEREFORE, FOR AND IN CONSIDERATION OF the foregoing recitals and the mutual covenants

hereinafter set out the parties hereto do mutually agree the one with the other as follows:

National covenants and agrees that:

1. It shall manage Producers in all material respects as a corporation separate and apart from the affairs of its subsidiaries, affiliates or itself.
2. It shall provide the time and effort of trained and capable employees for the performance of all underwriting, processing, servicing and accounting duties and functions normally carried on by life insurance company personnel.
3. It shall employ such personnel of Producers as it may gainfully employ in the supervision and management of the affairs of Producers or any of the affiliates of National.
4. It shall cause to be paid with the funds of Producers all costs of personnel, premium collections, issuance of policy contracts, preparation of records pertaining to policy contracts, office rental, and any and all other costs or expenses incurred by and on behalf of Producers in the operation of its insurance business, to the extent that such funds are available.
5. It shall provide the foregoing personnel, facilities and space at its home office or in its discretion, in any other of its office buildings in Arizona.

[2]

6. It shall accept at its offices payment in any legal form from applicants, policyholders, obligees, or agents, for the benefit of Producers, and deposit such payments in banking or savings accounts of Producers.
7. It shall make payments, in any legal form, to any applicants, policyholders, claimants, beneficiaries, agents, brokers, managers and other sales personnel, in the name and as the act and deed of Producers, for its benefit, in accordance with standard insurance practices, and subject to the supervision of the Board of Directors of Producers.

8. It shall cause to be prepared such financial reports and accounts as shall have heretofore been prepared by Producers, and shall upon request warrant the completeness and accuracy of the same to the stockholders of Producers and the appropriate state departments of insurance.
9. It shall manage the sales personnel of Producers conscientiously and with the intent of retaining and maintaining the aggressive sales program currently in effect for the benefit of Producers, subject to prudent management.
10. It shall issue insurance contracts to applicants, provide service to policyholders and pay or deny benefits or claims of claimants under the terms of insurance policies, all in accordance with standard insurance practices, and under the supervision of the Board of Directors of Producers.
11. It shall maintain reserves of Producers as required.
12. It may sell, offer for sale, purchase, offer to purchase, negotiate, mortgage, rent and in every manner manage the investments, assets and properties (whether real, personal, or mixed) on behalf of Producers, in the same manner as a prudent man in the same or similar circumstances might or would do and it may in no event sell to any of its affiliates any asset of Producers at less than the value at which any such asset is carried on the books of Producers at the time of sale.
13. It may dispose of such assets of Producers as shall not be necessary to maintain Producers' insurance business while operating under the terms and conditions of this agreement, at reasonable and prudent values, provided, however, that it may dispose of any security now owned by Producers, including but not limited to securities of corporations presently or heretofore affiliated with Producers (as the term affiliated is construed by the Securities and Exchange Commission of the government of the United States) to persons interested in buying the same, whether or not such persons have been or are affiliated with Producers, for the value at

which such securities are carried on the books of Producers; nothing herein contained to the contrary withstanding, National shall have and has the authority to sell any securities owned by Producers at less than book value in transactions with persons other than affiliates of Producers or National in the normal course of buying, selling, trading and investing in securities.

[8]

14. It shall pay all taxes, licenses, fees, permits, and other costs of doing business from the funds of Producers by and for and as the act and deed of Producers.
15. It shall cause to be done any and all other acts and cause to be executed any and all instruments deemed reasonable, desirable, convenient, or necessary, whether herein expressly set out or hereafter agreed to, to the end that the best possible management of the affairs of Producers, for its benefit and that of its policyholders and stockholders, shall be the result.
16. It shall propose the corporate amalgamation or reorganization hereinabove referred to to the stockholders of Producers and such stockholders of National, or one or more of its affiliates as may be appropriate, during the term of this agreement.

Producers covenants and agrees that:

1. It shall cause to be delivered to National at its home office all its records now or hereafter in its possession, pertaining to applications, insurance policies, claims, assets, liabilities and reserves and any and all other records requested by National.
2. It shall cause to be delivered to National at its home office any and all furniture, fixtures, equipment, machinery and whatsoever else National deems desirable to possess for the purpose of managing the affairs of Producers under the terms and upon the conditions herein contained.

38. It shall cause to be delivered to National at its home office all its stationery, checks, forms (for policies and other matters) to the end that personnel provided by National may possess, employ and execute them by, for and as the act and deed of Producers.

4. It shall cause to be forwarded to National at its address all correspondence and communications received by Producers and to permit National to alter Producers' mailing address and telephone number and exchange, to the end that all policyholders and members of the public at large receive proper and immediate service in relation to their affairs with Producers.

The parties hereto do mutually covenant and agree that:

1. This agreement shall be liberally construed to permit all necessary and usual services to policyholders, stockholders, and creditors of Producers consistent with economical management of Producers' affairs by National.
2. From the gross receipts of Producers (defined as all receipts of Producers other than proceeds realized from a bulk sale of insurance in force and other than that portion of the proceeds from the sale of any admitted asset represented by its admitted asset value as carried on the books of Producers) there shall be allocated in the following order the sums necessary to:
 - a. Maintain required reserves;
 - [4] b. Make all payments required under any and all policy contracts of Producers, as the same become payable from time to time;
 - c. Contribute to the surplus of the corporation, for its benefit and that of its stockholders, an average of \$7,500.00 per month from and after July 1, 1964, and for each month thereafter during the term of this agreement;
 - d. Meet all other obligations and expenses of the corporation;
 - e. In the event gross receipts of Producers exceed the foregoing sums to be allocated and paid,

any such excess shall be and is the management fee due and shall be paid to National; in the event such gross receipts are insufficient to meet the foregoing sums to be allocated and paid, any deficiency therein shall be made up and paid by National.

3. In addition to the foregoing contribution to the surplus of Producers, its surplus or security valuation reserve shall also be increased (or decreased) by the gain (or loss) realized from the sale of any securities or security instruments (other than agents' balances due Producers) which were owned by Producers as of the day and date first hereinabove written, and its surplus shall be reduced by any and all dividends paid to stockholders and income taxes paid to the United States.
4. The term of this agreement shall be for five years commencing on the day and date first hereinabove written, unless sooner terminated by the consummation of the aforesaid amalgamation or reorganization which shall be construed as terminating this agreement.
5. This agreement shall be binding upon any successor to National with the same force and effect as upon National.
6. In the event either party hereto shall breach this agreement or shall fail to perform any covenant herein agreed to be performed, and any such breach or failure is not remedied within 90 days after notice of the same by the injured party to the party causing the same to occur, the latter party, that is to say, the party causing any such breach or failure to occur and failing to remedy the same as aforesaid shall be then and thereupon indebted to the other party hereto in the amount of: \$450,000 if such breach or failure should occur within the first twelve months of this agreement; \$360,000 if the same should occur in the second twelve months; \$270,000 if the same should occur in the third twelve months; \$180,000 if the same should occur in the fourth twelve months; and \$90,000 if the same should occur in the fifth twelve months; and the

foregoing amounts are hereby deemed to be fair and equitable estimates of damages which each party hereto shall have suffered in the event the other causes such a breach or failure to go unremedied and thereby causes the injured party to restore itself to the position in which it was prior to the execution and carrying into effect of this agreement.

7. If any provision herein contained shall be deemed or construed by a court of law or in equity, or any other tribunal [5] or agency having jurisdiction over this agreement or the parties hereto, to be contrary to law, such construction or determination shall not affect any other provision herein.
8. This agreement shall be without force or effect until the same shall have been approved by the Director of the Department of Insurance of the State of Arizona.

IN WITNESS WHEREOF, the parties hereto have caused this agreement to be executed by their officers, duly authorized, and their seals to be hereunto affixed as of the day and date first hereinabove written.

NATIONAL SECURITIES, INC.

By /s/ R. H. Wallace, President
R. H. WALLACE, President

ATTEST:

/s/ George B. Sharp
GEORGE B. SHARP, Secretary

PRODUCERS LIFE INSURANCE
COMPANY

By /s/ Arthur W. Saffert
ARTHUR W. SAFFERT, President

ATTEST:

/s/ Breeferd W. Large, Jr.
BREEFERD W. LARGE, JR., Secretary

APPROVED, this 15 day of May, 1964:

/s/ G. A. Bushnell
GEORGE A. BUSHNELL, Director
Department of Insurance, State of Arizona

EXHIBIT 9**NOTICE OF SPECIAL MEETING OF
STOCKHOLDERS AND PROPOSED MERGER
TO THE STOCKHOLDERS OF PRODUCERS LIFE
INSURANCE COMPANY:**

NOTICE IS HEREBY GIVEN that a special meeting of the stockholders of Producers Life Insurance Company will be held at 10:00 A.M., Mountain Standard Time, on Thursday, December 31, 1964, at Phoenix Little Theater, 25 East Coronado, Phoenix, Arizona, for the purpose of considering the following special topics and such other matters which may properly come before the meeting or any adjournments thereof:

1. The approval of a Consolidation Agreement and Plan of Reorganization dated November 27, 1964, by and between Producers Life Insurance Company and National Life & Casualty Insurance Company, providing for the merger of National Life & Casualty Insurance Company into Producers Life Insurance Company, which shall be the surviving corporation, to be thenceforth known as "National Producers Life Insurance Company".

2. The approval of the resolution of the Board of Directors which authorizes, subject to stockholders' approval of the Consolidation Agreement and Plan of Reorganization, of the payment of a dividend in common stock in the amount of one share for each five shares now outstanding to the stockholders of record as of 10 days following the "final effective date" as defined in this agreement.

3. The approval of an amendment to the Articles of Incorporation to effect a change in the date of the annual meeting from the last Thursday in February to the second Tuesday in June.

4. The approval of a resolution adopted by the Board of Directors amending the Bylaws by increasing its size to nine members and providing in part that the terms of Directors shall be three years with the terms of three Directors expiring each year.

5. The election of a Director to fill the vacancy resulting from such increase.

6. Other business which may properly come before the meeting.

Only stockholders of record at the close of business on December 1, 1964, will be entitled to vote at the special meeting or any adjournments thereof.

The value of the total assets and total liabilities, including required reserves, of Producers Life Insurance Company as of June 30, 1964, are set forth in Paragraph 18 of the Consolidation Agreement and Plan of Reorganization, forming a part thereof. The Consolidation Agreement and Plan of Reorganization is included herewith as a part of this notice.

This notice is dated November 27, 1964.

/s/ Breeferd W. Large, Jr.
Secretary

**CONSOLIDATION AGREEMENT
AND
PLAN OF REORGANIZATION**

WITNESS THE TERMS OF THIS CONSOLIDATION AGREEMENT AND PLAN OF REORGANIZATION made and entered into as of the 27th day of November, 1964, by and between PRODUCERS LIFE INSURANCE COMPANY, a corporation organized and existing under the laws of the State of Arizona (hereinafter called "Producers" or the "surviving corporation"), and NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation organized and existing under the laws of the State of Arizona (hereinafter called "National Life"). For the limited purposes set forth herein, including specifically the cancellation of that certain management agreement, dated April 30, 1964, by and between National Securities, Inc. and Producers, NATIONAL SECURITIES, INC., a corporation organized and existing under the laws of the State of Colorado and qualified to

do business in the State of Arizona (hereinafter called "National Securities"), is also a party hereto. The said management agreement is hereinafter called the "Management Agreement."

RECITALS:

1. *Identity of Parties.* Producers, the surviving corporation, was incorporated December 15, 1949, under the insurance laws of the State of Arizona, and National Life was incorporated May 26, 1936, under the insurance laws of the State of Arizona. Producers commenced business on July 31, 1952, and National Life commenced business on September 1, 1936. As of December

3. *The Consolidation Provisions of Arizona Law.* Under provisions of § 20-731A, Arizona Revised Statutes, an Arizona domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of the Arizona law governing the merger or consolidation of stock corporations formed for profit, subject only to the requirements that no such merger or consolidation shall be effected unless in advance thereof the plan and agreement therefor have been filed and approved in writing by the Director of Insurance of the State of Arizona. By the terms of §§ 10-341 through 10-349, both inclusive, Arizona Revised [2] Statutes, two or more corporations formed for profit may be consolidated and continued as one of the constituent corporations or by forming a new corporation subject to certain requirements, including the submission of the agreement for merger to the shareholders of both corporations and its approval by a vote of not less than $\frac{2}{3}$ rds of the outstanding shares of both corporations.

4. *Principal Purpose of Agreement.* The principal purpose of this Agreement is to provide for the merger of National Life into Producers, which will continue as the surviving corporation, governed by the laws of the State of Arizona.

5. *Secondary Purpose of Agreement.* The secondary purpose of this Agreement is to provide for the cancella-

tion of the Management Agreement by and between National Securities and Producers, subject to the further provisions hereof.

NOW, THEREFORE, for and in consideration of the foregoing recitals and for and in consideration of the mutual covenants and warranties hereinafter set forth, the merging parties hereto, deciding to merge, and National Securities, desiring to bind itself to the terms and conditions hereof as relate to it, agree one with the other as follows:

6. *Merging Parties to Submit Agreement to Director.* Immediately upon execution of this Agreement, National Life and Producers shall join in submitting forthwith a counterpart of this Agreement to the Director of Insurance of the State of Arizona. Each merging party agrees to take every legal and reasonable step to secure approval of this Agreement by the Director of Insurance. Such approval shall be endorsed on a counterpart of this Agreement as a condition precedent to the consummation of the merger; provided, however, that if any modifications of this Agreement are subsequently executed by and between the parties hereto, they shall be immediately submitted by the merging parties in the same manner as the counterpart of this Agreement was submitted, and all legal and reasonable steps to secure approval of any modification shall be undertaken and performed by the merging parties in the same manner as required of them in submitting the counterpart of this Agreement.

7. *Submission to Stockholders.* Immediately upon execution of this Agreement, each merging party shall issue to its stockholders a notice substantially in the form of Exhibit "A", in the case of Producers, and substantially in the form of Exhibit "B", in the case of National Life (but such exhibits shall not be deemed a part of this Agreement for the purpose of subsection 4 of § 10-343B, Arizona Revised Statutes). The special meeting of the stockholders of the companies hereto referred to in Exhibits "A" and "B" shall be held on the same day and at such special meetings this Agreement shall be submitted to the stockholders of each company. At such meeting, if a quorum sufficient to approve this Agree-

ment be present in person or by proxy, this Agreement shall be submitted to the stockholders of the respective companies for approval; if at either meeting a quorum be not present in person or by proxy, this Agreement shall not be submitted at such meeting, but such meeting shall (after consideration of other business) be adjourned, recessed or rescheduled. If this Agreement be approved by the requisite majority (voting in person or by proxy) of both companies, then the day of the later meeting at which such approval was voted shall be, for the purposes hereof, referred to as the "meeting day".

8. *Further Acts of Parties.* Following the meeting day, the merging parties and their officers and directors, shall execute and file all documents and papers necessary and required by the consolidation and insurance laws of the State of Arizona. Such execution and filing shall [3] be accomplished as soon as possible after the final meeting day as can be, and the day upon which the last document, required to be filed by the laws of the State of Arizona to effect a valid merger, is filed shall be deemed for purposes of this Agreement to be the "final effective date". On the final effective date, but nevertheless for all purposes whatsoever as of December 31, 1964, regardless of the actual date, Producers, the surviving corporation, shall become the owner of all assets and assume all liabilities of National Life, including policy liabilities all as of December 31, 1964, and National Life shall cease to exist as a corporate entity.

[6] 20. *Modification or Abandonment of Merger.* Until this Agreement has been approved by the stockholders of either merging party hereto, the parties may (by and through their Boards of Directors) effect reasonable modifications hereof deemed by them to be necessary or desirable, except for changes in the exchange ratio provided for in Paragraph 12 hereof, which shall not be subject to modification. Such modification shall not be effective until approved by the Director of Insurance of the State of Arizona. After this Agreement has been approved by the stockholders of either but not both merging parties hereto, the party which has not obtained stockholder ap-

proval shall have a reasonable time, not to exceed three months, in which to obtain stockholder approval. If at the end of the three months' period (which shall begin as of the date the first merging party obtains its stockholders' approval), the other merging party has not obtained stockholder approval (unless the party obtaining stockholder approval has in writing extended the time in which this Agreement may be performed), this Agreement shall be deemed abandoned and the provisions hereof of no further force and effect. Otherwise, this Agreement shall not be abandoned except as directed in writing by the Director of Insurance of the State of Arizona.

[3] 12. *Manner of Converting the Shares and Assets of National Life.* If this Agreement be approved on the meeting day (as defined herein) by the stockholders of Producers and National Life, Producers shall issue and deliver to the stockholders of National Life shares of the common capital stock of Producers (subject to the provisions of Paragraph 16 hereof) in accordance with the following ratio: for each share of National Life stock now issued and outstanding there shall be issued one share of Producers stock. The shares of National Producers to be issued pursuant hereto shall be deemed to have been issued and outstanding as of the final effective date and shall be issued as soon as may be reasonably convenient thereafter. A National Life stockholder after the final effective date, but before surrender of his National Life share certificates representing validly outstanding shares of common stock of National Life, shall be deemed, for all corporate and legal purposes, to be the owner of that number of National Producers shares to which the formula hereinabove set forth shall provide, but the surviving corporation shall not be required to issue any share certificates to such stockholder until the certificate or certificates representing his National Life shares are surrendered, and his ownership thereof established by the reasonable and customary evidence required for the transfer of corporation shares.

EXHIBIT 10

**PRODUCERS LIFE INSURANCE COMPANY
AN OLD LINE LEGAL RESERVE COMPANY**

2300 N. CENTRAL • PHOENIX, ARIZONA • AL 8-5711 • P.O. Box 1870

November 27, 1964

Dear Stockholder:

Your Board of Directors wholeheartedly recommends your favorable consideration of several proposals of utmost importance to you and your company. These proposals include:

The *merger* of your Company and National Life & Casualty Insurance Company, whereby *Producers Life* will be the surviving company. We would also take 'National' into our name and become 'National Producers Life Insurance Company'. Your Company would have nearly *two-hundred million* of life insurance in force, over *nineteen million* of assets and more than *seven million* per year income;

Immediately upon approval of the merger proposal by stockholders (and their ratification of the Resolution adopted by its Board of Directors) Producers Life will declare a *twenty percent stock dividend* to all stockholders of Producers Life.

The very size of the Company resulting from this merger should improve the image and prestige of your Company, multiply its profit potential, increase its ability to expand into new areas, secure more business from the markets it is currently serving, and improve the market for your stock. All of these factors are discussed in greater detail in this letter. The other proposals are fully described in the enclosed materials (the 'Notice of Meeting' and the 'Consolidation Agreement').

The merger and other proposals will be voted upon at a Special Stockholders Meeting on December 31, 1964. This merger, vital to the future of your Company, can only

become effective upon the approval of two-thirds of the outstanding stock. Therefore your support is of critical importance.

Only the enclosed proxy can be voted in favor of the merger. Even though you may have a proxy on file with the Company, it is necessary that the special proxy enclosed be signed and returned promptly.

[2]

SIZE

The significance of the size of your Company, after the merger, can be more easily appreciated by making certain comparisons. The nearly two-hundred million of insurance in force, over nineteen million of assets and projected 1965 income of more than seven million dollars — means that your Company:

Would have approximately twice the premium income and assets of the next largest Arizona life insurance company;

Would have nearly ten percent of the total insurance in force of all 146 Arizona life insurance companies;

Would rank in the upper 20% of all of the life insurance companies in the United States in insurance in force.

In addition, the merger of two strong, productive sales organizations promises the highest volume of new sales in our history. This sales force of approximately 250 licensed agents can reasonably be expected to write an average of five million of new business per month during 1965—(\$60,000,000 of insurance for the year).

PROFITS

In almost every phase of company operations, this merger should eliminate duplication of work and result in substantially lower operating costs. The effect of anticipated operational economies can easily be seen by reviewing the pro-forma operating statement, which projects management's estimates for 1965, printed at the end of this report. The before-tax net profit from operations for 1965 alone of \$460,00 would be:

Greater than the *total* before tax profits of National Life & Casualty for the past *five years*; and

More than *twice the total* before tax profits of Producers Life for the same five year period.

This comparison can be seen more clearly when itemized by years:

	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>5 Yr. Total</u>
National Life	\$141,903.	\$70,615.	\$ 25,778.	\$189,268.	\$ 8,591.	\$436,155.
Producers	(35,943.)	5,770.	152,781.	127,738.	(20,732.)	229,559.

(The above amounts are the net profits (loss) before Federal Income Taxes as reported on annual statements filed with the Insurance Department.)

The combination of lower operating costs plus higher volume of sales should further strengthen our profit potential for the future.

[3] MARKET FOR YOUR STOCK

In the past, lack of continuous investor interest has resulted in neither Producers Life nor National Life stock having a consistently good market. This is apparent from published market reports contained in our files and available to stockholders on request. Your Board feels that major reasons for this investor apathy were a combination of: Failure to show consistent and increasing profits, lack of size, regionalized sales activities, and lack of a broad market for the stock.

Through this merger your Company will have the size, strength, profit potential and expanding sales activities that should attract substantial investor interest. Your Board firmly believes that *a strong and increasing demand for the stock of your company would move the price of the stock to levels that would be more attractive for all stockholders.*

MANAGEMENT AGREEMENT ENDS

At the time of our affiliation with National Securities, I wrote you that it was our intent to merge Producers Life with National Life as soon as practicable. Meanwhile we

needed a method by which we could work towards an orderly consolidation. This method was the Management Agreement.

Under the Management Agreement it was possible for your company to retain its identity, protect the interests of all stockholders, policyholders and employees, and still have all the advantages of highly efficient and automated facilities. We were able, during the past seven months, to develop many common methods of operation with National Life that are far more effective and efficient than Producers Life had ever known in the past. We were able to develop new insurance policies, competitive rates, and new services for policyholders that brought our two companies closer together. At the same time, we had the services of top men in their fields to help us work towards this merger.

Now we are able to recommend the merger with the firm knowledge that the transition will work fully to the advantage of all stockholders.

[4] NATIONAL SECURITIES' POSITION

With the merger, National Securities will give up its 70% ownership in National Life and its position under the Management Agreement. After the merger, National Securities will own approximately 30% of the outstanding stock in the merged company.

As a minority stockholder, the profits per share on its stock will be exactly the same as on yours. Its interest as a stockholder will be the same as yours in building company earnings for the benefit of all stockholders. National Securities believes, as does your Board of Directors, that the growth and profit opportunities for a company of the size being created by this merger are far beyond what could be expected for the separate companies for many many years to come. *For these reasons National Securities is willing to take a minority position in the merged company.*

BASIS OF THE MERGER.

The merger is proposed on the basis of the relative asset value of the two companies, including the fair value of business in force. Management believes that this method of determining relative value is the most equitable for merger. For an analysis of these values, see the financial statements contained in this report.

The purpose of the proposed stock dividend is to increase your stock ownership in Producers Life and to equalize the per share value of the two companies.

BALANCE SHEETS June 30, 1964

Pro Forma
National Producers
Life Insurance Company
(as if the proposed merger
had been effective
June 30, 1964)

National Life and
Casualty Insurance
Company

Producers
Life Insurance
Company

ASSETS

CASH

\$ 685,118

\$ 269,940

\$ 955,053

AMOUNTS DUE FROM OTHERS:

Real estate loans and contracts
Policy loans

\$2,520,162
1,389,944

\$8,108,883

\$ 5,829,045

Collateral loans

468,687

296,682

1,686,626

Premiums due and deferred

35,203

244,800

244,800

Investment income due and accrued

165,923

633,826

1,102,463

Other

4,579,874

76,532

111,735

372,704

INVESTMENTS:

Stocks and bonds

\$1,602,916

\$5,265,427

\$ 6,868,337

Stocks of Producers Life

1,174,566

264,364

1,174,556

Treasury stock

717,048

5,529,791

931,412

Real estate

113,850

85,670

113,850

Other

425,359

9,138,155

511,029

OTHER ASSETS

TOTAL ASSETS

\$9,298,710

\$10,452,900

\$19,751,610

LIABILITIES

CURRENT TRADE LIABILITIES:

General expenses and taxes payable

\$ 75,775

\$ 74,042

\$ 149,817

Unearned investment income

29,938

6,084

36,022

Amounts held for others

42,854

23,048

65,902

\$ 251,741

AMOUNTS HELD FOR POLICYHOLDERS:

Policy reserves

\$6,267,069

\$5,974,835

\$12,231,904

Dividend accumulations

422,175

1,416,510

1,838,685

Advance and deposit premiums

146,758

281,830

428,588

58,773

14,557,950

\$14,809,691

TOTAL LIABILITIES

\$7,012,847

\$ 7,796,344

\$ 1,038,473

SHAREHOLDERS' EQUITY

CAPITAL STOCK

ASSIGNED SURPLUS:

Security valuation reserve

\$ 86,683

\$ 145,384

\$ 85,780

Contingency reserve

821,759

821,759

100,000

Reserve for losses on real estate loans

567,143

1,206,937

\$ 507,589

UNASSIGNED SURPLUS:

TOTAL BOOK VALUE

\$ 86,683

\$ 567,143

\$ 507,589

ADDITIONAL EQUITY VALUES:

Unrealized appreciation of real estate

\$ 533,875

\$ 279,753

\$ 813,628

Valuation of insurance in force

2,736,000

\$ 3,109,753

\$ 6,879,628

TOTAL EQUITY VALUE

\$5,555,738

\$ 5,765,809

\$11,321,547

SHARES OUTSTANDING (after Stock

Dividend in Producers)

1,018,574

\$ 1,058,371

\$ 2,076,945

EQUITY VALUE PER SHARE

\$5.45

\$5.45

\$5.45

The above Pro Forma Balance Sheet gives effect as of June 30, 1964, to the following.

(1) The proposed merger of National Life into Producers Life.

(2) The proposed 20% stock dividend in Producers Life.

(3) The proposed reduction of the par value of the stock, after the merger, from \$1 to 50¢.

(4) The intent of the Company to hold the treasury stock created by the merger, for subsequent public distribution.

(5) This statement has been prepared to reflect full value of all assets to permit adequate comparison for merger purposes.



[6] **SUBJECTS TO BE VOTED ON AT
SPECIAL MEETING DECEMBER 31, 1964**

- Merger with National Life & Casualty - - - (with Producers Life to be the surviving Company)
- Ratification by stockholders of resolution of the Board of Directors declaring a 20% stock dividend - - - - - (payment of this dividend is subject to the approval of the merger)
- Increase in the Board of Directors to nine - - - (to provide for representation on the Board of all principal departments of our Company's operation)
- Staggering the terms of the Directors - - - (to assure a continuity of policy and operations)
- Change in the date of the annual meeting to the second Tuesday in June - - - (to comply with new regulations expected to become effective in 1965, requiring that audited statements be sent to stockholders 30 days in advance of the annual meeting each year).

MAIL THIS SPECIAL PROXY TODAY

It is extremely important to you and to the other 13,000 stockholders of Producers Life that you send in the enclosed proxy now. *This is the only proxy that can be voted in favor of the merger . . . and the 20% stock dividend is payable only if the merger is approved.*

This merger requires the affirmative approval of stockholders owning two-thirds of the outstanding stock. *Failure to vote is the same as a vote against the merger.* Regardless of whether you have a proxy on file, no proxy other than this *special proxy* can be voted in favor of this merger.

Won't you please sign and mail this proxy today?

/s/ A. W. Saffert

A. W. SAFFERT, President

SUMMARIES OF EARNINGS

(Earnings Before Federal Income Taxes as Reported on Annual Statements to Insurance Departments)

	Year Ended December 31, 1963	(Pro Forma) Year Ending December 31, 1965
	National Life & Casualty Insurance Company	Producers Life Insurance Company
Premiums and other considerations:		
Life insurance	\$2,432,149	\$2,439,904
Accident and health insurance	78,581	173,506
Supplementary contracts	229,113	208,758
	\$2,739,843	\$2,822,168
Net investment income	302,066	397,911
Other income	23,718	
	\$3,060,627	\$3,220,079
Death and other benefits	\$1,133,243	\$ 691,247
Increase in life policy reserves	721,218	996,044
	\$1,854,466	\$1,687,291
Balance	\$1,206,174	\$1,532,788
Commissions	\$ 414,249	\$ 521,650
Salaries and general insurance expense	604,081	843,104
Taxes, licenses and fees	54,592	56,316
Increase in loading on deferred and uncollected premiums	25,432	52,263
	\$1,098,354	\$1,473,333
Total Income from Underwriting and Investment	\$ 107,817	\$ -59,455
Dividends to Policyholders	99,226	85,866
Net Income (Loss) Before Taxes	\$ 8,591	\$ (26,411)
		\$ 460,000

[Entered March 30, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. Civ-5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRET, JOSEPH B. SETTER, BREEFERD W. LARGE, JR., RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM A. REEDY, BONNIE B. BILBREY, PRODUCERS LIFE INSURANCE COMPANY, a corporation, and PRODUCERS THRIFT & LOAN COMPANY, a corporation, DEFENDANTS,

TEMPORARY RESTRAINING ORDER

The Securities and Exchange Commission having moved for a temporary restraining order and it appearing to the Court from the complaint for injunction and the affidavit of W. Stevens Tucker filed herein that the defendants National Securities, Inc., a corporation; National Life & Casualty Insurance Company, a corporation, Robert H. Wallace, Robert C. Bohannon, Jr., Arthur W. Saffert, Ted Williams, John S. Barrett, Joseph B. Setter, Breeferd W. Large, Jr., Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey, [2] Producers Life Insurance Company, a corporation, and Producers Thrift & Loan Company, a corporation, are engaged and are about to engage in acts and practices which constitute violations of Section 10(b) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, to the serious injury and prejudice of Producers Life Insurance Company and its stockholders—

IT IS ORDERED, ADJUDGED AND DECREED that said defendants, and each of them, their agents, attorneys, employees and assigns, and all persons acting in concert or participation with them, be and they are temporarily restrained and enjoined from, directly or indirectly—

A. making use of any means or instrumentality of interstate commerce or of the mails to engage in any manipulative or deceptive device or contrivance, in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, in connection with the purchase or sale of securities issued or to be issued by Producers Life or National Life or National Securities, or any affiliate or subsidiary of any of such issuers, involving any plan or arrangement between the managing directors of Producers Life and the managing directors of National Securities or National Life to surrender and transfer to National Life the directorships or offices of the managing directors of Producers Life, together with voting proxies sufficient to ensure dominion over and control of Producers Life by National Life and National Securities, or the ultimate merger, consolidation or amalgamation of Producers Life and National Life, in derogation of the rights and interests of the stockholders of Producers Life and in contravention of the fiduciary obligations of the defendants or any of them to Producers Life and its stockholders, a) by employing any device, scheme or artifice to defraud; b) by making any untrue statement of material fact or omitting to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or c) by engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon Producers Life or its stockholders, whether through—

[3]

- (1) the device of a plan of reorganization, consolidation, merger or otherwise, and specifically through implementation or consummation of the Consolida-

tion Agreement and Plan of Reorganization executed by Producers Life Insurance Company, National Life Insurance Company and National Securities, Inc., dated November 27, 1964; or

- (2) the solicitation of proxies or votes of stockholders to be used to accomplish any such plan of reorganization, consolidation or merger; or
- (3) any untrue statement of material fact or omission to state any material fact, necessary in order to make the statements made in the light of the circumstances under which they are made not misleading, with respect to:
 - (a) the dollar amount of any liabilities or obligations assumed or to be assumed by Producers Life or the surviving company in any merger involving Producers Life;
 - (b) the assets, liabilities, capital, surplus or deficit, income or losses of Producers Life or National Life or of any other company with which it may be proposed to merge or combine Producers Life;
 - (c) any transaction which materially affect the assets, liabilities, capital surplus or deficit, income or losses of Producers Life, National Life, or of any other company in which it may be proposed to merge, combine or consolidate Producers Life; or
 - (d) any forecast as to the earnings, income or amount of business of Producers Life, National Life or of any surviving company into which Producers Life may be merged, combined or consolidated;

[4] or engaging in any act, practice or course of business of similar object or purport; or

B. voting or causing to be voted any proxies executed by stockholders of Producers Life which have been received by the defendant Wallace from the defendants Johnson, Richards or Reedy;

C. voting any proxies executed by stockholders of Producers Life appointing the defendants Saffert and Wal-

lace, or either of them, which were solicited or received subsequent to April 27, 1964;

D. voting any of the 185,008 shares of stock of Producers Life held by National Life as of December 31, 1964; or

E. performing any act which facilitates or is designed to facilitate the consummation of the Consolidation Agreement and Plan of Reorganization dated November 27, 1964, between Producers Life, National Life, and National Securities.

This temporary restraining order shall expire at 4:50 P.M. on April 9th, 1965, unless otherwise ordered by the Court for good cause shown.

Dated March 30, 1965, at 4:50 P.M.

Presented by:

/s/ W. Stevens Tucker
W. STEVENS TUCKER
Of Counsel for the United States
Securities and Exchange Commission

/s/ [Illegible]
United States District Judge

59
[Filed April 13, 1965]

[Excerpts From Exhibits Included in Supplemental
Affidavit of W. Stevens Tucker]

EXHIBIT A

PRODUCERS LIFE INSURANCE COMPANY
AN OLD LINE LEGAL RESERVE COMPANY
2300 N. CENTRAL • PHOENIX, ARIZONA • AL 8-5711 • P.O. Box 1870

January 1, 1965

STOCKHOLDERS GIVE MANAGEMENT
OVERWHELMING SUPPORT

Stockholders voted two to one in favor of Producers Life management on every issue voted on at the December 31, 1964 special meeting.

Management's candidate to the Board of Directors, Joseph C. Shorrock, was elected by a vote of 536,787 to 222,820.

Management's proposal to stagger the terms of the members of the Board to provide for a continuity of management was approved by a vote of 542,384 to 217,329.

Management's proposal to move the date of the annual meeting to June was approved by a vote of 542,172 to 217,487.

Unfortunately, because of the snarl of last minute legal actions filed by the 'stockholder's committee', the merger was not voted on. This legal tangle was created by the 'committee' just two days before the meeting, as the 'committee' was rapidly losing stockholder support.

The meeting was recessed and will be re-convened as soon as practical for the vote on the merger. We are as anxious as you are to have the merger approved.

While we believe there is not one chance in a thousand that any of these desperation legal maneuvers by the

'committee' can succeed, we did not wish to hazard the problems of "un-merging" the two companies. Therefore, management believes it best to have the short delay.

[EXHIBIT C-2]

[Producers Life Insurance Company]

[Headquarters Report]

CUTTING COSTS . . . INCREASING PROFITS

National Securities headquarters serves all affiliated companies including Southwest Savings & Loan Association, Tucson Title Insurance Company, Western States Title Insurance Company, Associated Mortgage & Investment Company, and National General Agency . . . in addition to Producers Life and National Life. These affiliated companies have more than \$75 million dollars in assets.

Individually, the companies are of moderate size. Collectively they represent a powerful financial force with impressive resources. Through the centralization of major equipment and top personnel, every affiliate has access to all available services and facilities. This centralization at National Securities has created an impressive, modern, headquarters nerve center giving all companies better customer service, more efficient operations and lower overhead expenses than they could afford individually.

The computer facilities are an excellent example of this. Producers Life never had computers. All clerical and accounting tasks were done by hand, or by standard accounting and processing machines. Today, computers calculate and print over 100 different projects per month directly on forms for mailing to policyholders or processing at the Home Office. Computers make two-million-four-hundred-thousand (2,400,000) calculations per minute . . . read 450 policies per minute . . . and print information in the form of words and numbers at the rate of 600 lines per minute.

[2]

TOP PERSONNEL

[3]

IMPROVING SALES POTENTIAL

Five insurance companies are in the National Securities group, so it is not strange that the headquarters staff includes top, nationally known and respected insurance personnel. In fact, this is a primary reason why former Producers Life management came to National Securities when they decided to step down.

This headquarters group includes life insurance specialists in accounting, auditing, advertising, sales promotion, actuarial science, data processing, investments, administration, personnel and other important phases of corporate activities. Producers Life could never afford to maintain a staff of this magnitude, yet your company has the services of all these people available at all times. This advantage is matched by very, very few companies. The cost of this headquarters staff is shared by all National Securities companies and your company draws on those people and those talents it needs.

For Producers, this concentration of top personnel has already had some important benefits.

For example, within six months the National Securities headquarters staff had changed Producers Life to the 1958 CSO tables which immediately put your company in a better competitive position through more competitive life insurance rates. Also within six months, this staff added over 45 new policies to those offered by your company, put new audio-visual materials in the hands of salesmen, and developed an entire series of sales promotion materials to help your salesmen do a more effective selling job. In nine months, new payment plans were introduced for policyholders, new sales advance plans were in effect and new, faster, more efficient systems developed and in operation for billing, delinquency notices, etc.

This is only a sample of the way in which the National Securities headquarters group is capable of producing swift, profitable results for the merged company.

[8] MAKING COMPANIES GROW

For an idea of what can happen in the future for the merged company, you can look back on what *has* happened to other National Securities affiliates. Here you can see how the National Securities headquarters operations and practices put companies in excellent positions to move forward quickly for the benefit of stockholders.

Southwest Savings. Acquired in 1960. Assets at that time were approximately six million dollars. Today, assets are over fifty million dollars . . . an increase of over 800%. Since 1960, assets per share have increased 524%; savings have increased 574%; reserves, capital, surplus and undivided profits have increased 852%. One office in 1960 has grown to five offices today.

Associated Mortgage & Investment Company. Founded in 1957. Since 1960, assets have increased 2,772%. Mortgage loan service portfolio has increased 67%. Company has expanded into Tucson, Salt Lake City, Los Angeles.

Tucson Title Insurance Company. Acquired in 1962. Today it is the largest title company in southern Arizona, doing over 80% of the total volume of the Tucson area.

Western States Title Insurance Company. Acquired in 1963. Since then, sales have increased 42%, profits are up 11% and the company has expanded into Ogden and Bountiful. Western States is the largest title insurance underwriter in Utah. Headquarters are in Salt Lake City.

National General Agency. Founded in 1963 as a managing general agency in the fire and casualty fields. Currently specializing in serving affiliated companies with plans being finalized for expansion into other areas.

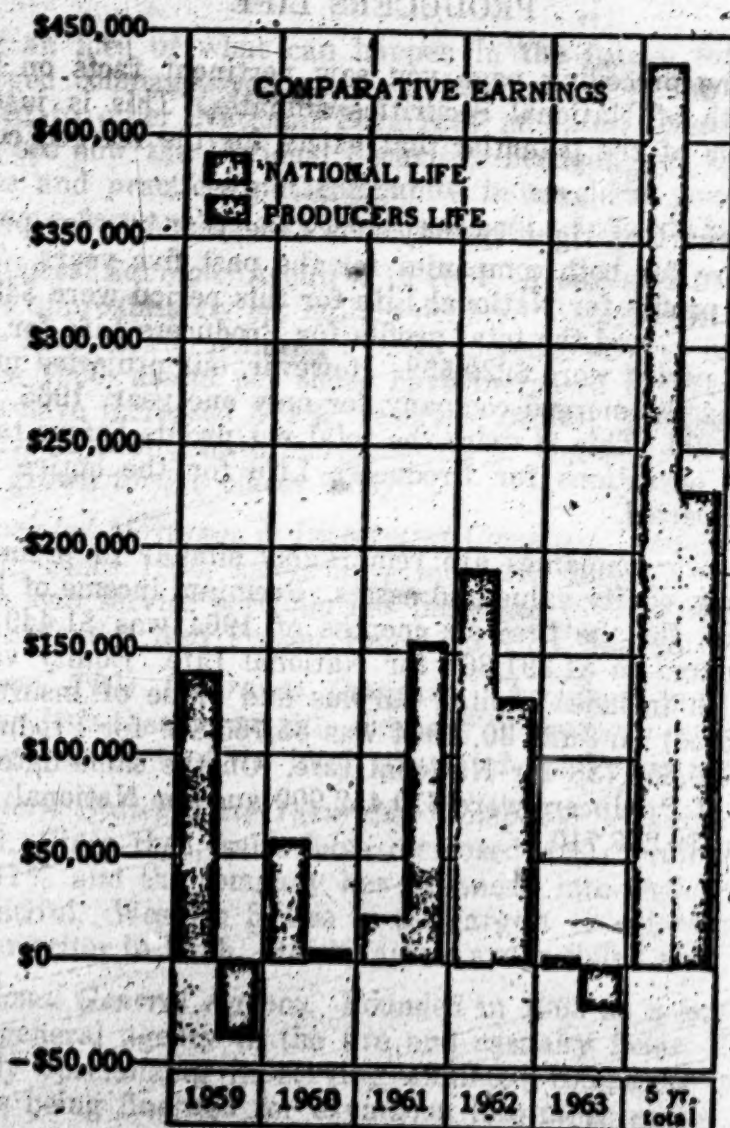
[4]

**NATIONAL LIFE AND
PRODUCERS LIFE**

On the preceding page you saw pertinent facts on the growth of National Securities affiliates. This is just a sample of the potential that exists for the merged company.

The chart at right [p. 64] shows the year-by-year profit picture for both companies for the past five years. The total profits for National Life for this period were \$436,155 and the total profits for Producers Life for the same period were \$229,559. However, our projected profits for the merged company for only one year, 1965, are \$460,000. This is twice the total net profits before taxes from operations for Producers Life for the entire five year period.

The two companies are remarkably similar in premium income, equity value and assets. Premium income of Producers for the first six months of 1964 was \$1,440,049 compared to \$1,391,867 for National Life. Equity value (which includes capital, surplus and value of insurance in force) on June 30, 1964 was \$5,765,809 for Producers and \$5,555,738 for National Life. On the same date assets of Producers were \$10,452,900 and for National Life were \$9,298,710.



(The above amounts are the net profits (loss) before Federal Income Taxes as reported on annual statements filed with the Insurance Department.)

[Filed April 15, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. Civ.-5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRET, JOSEPH B. SETTER, BREEFERD W. LARGE, JR., RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM A. REEDY, BONNIE B. BILBREY, PRODUCERS LIFE INSURANCE COMPANY, a corporation, and PRODUCERS THRIFT & LOAN COMPANY, a corporation, DEFENDANTS

ANSWER OF THE DEFENDANTS NATIONAL SECURITIES, INC., NATIONAL LIFE & CASUALTY INSURANCE COMPANY, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY

Defendants listed above, for brevity hereafter called the National Securities-Producers Group, for their answer allege:

1. This Court has no jurisdiction of this matter, the matters complained of not in fact being within any jurisdiction given to the Court under the Securities Act of 1934.

2. The complaint fails to state a claim upon which relief can be granted.

In addition, the defendants for further answer, following the unit numbers of the complaint herein, answer as follows:

I

1. The allegations of paragraph 1 are denied in all respects, including expressly a denial that it "appears to the Securities and Exchange Commission." The defendants allege that they have made their best efforts to determine whether at the time of filing this complaint the matter involved did "appear to the Securities and Exchange Commission" and have been unable to do so. Therefore, being unable to form a belief, they expressly deny this allegation.

2. Paragraph 2 alleges that this action arises under Sec. 21(e) of the Act, 15 U.S.C. Sec. 78(e). Defendants assume that this is a typographical error and that the section intended is 15 U.S.C. Sec. 78(u)(e). The defendants deny, as set forth in the preceding paragraph, that this matter does "appear to the Commission" and in any case deny that any matter is alleged which, even if proved, would constitute violation of the provisions of this chapter.

3. The allegations of paragraph 3 are denied.

II

1. The allegations of paragraph 1 are admitted.

2. The allegations of paragraph 2 are admitted.

3. The allegations of paragraph 3 are admitted except insofar as the paragraph alleges that these various persons are subject to the direction and control of the defendant Wallace, and in this respect, the paragraph is denied; and it is further denied that Mr. Bohannon is an Executive Vice President of National Life; or that Wilkins was employed as alleged.

4. The allegations of paragraph 4 are admitted.

5. The allegations of paragraph 5 are admitted insofar as they allege that these were the Board of Directors at the time in question; as to the remainder concerning the control and management of the corporation, these defendants do not have sufficient information to form a belief.

6. The allegations of paragraph 6 are admitted.

7. The allegations of paragraph 7 are admitted insofar as the number of shares owned by the named persons. As to the "control" of the shares of Producers Thrift, this relates to the internal management of this corporation and these defendants have not sufficient information or belief to plead thereto. However, it is believed that the number of shares to which the plaintiff meant to make reference was 38,984 instead of 38,904 as pleaded.

8. The allegations of paragraph 8 are admitted.

III

1. The allegations of paragraph 1 are denied in each and every particular.

2. The allegations of paragraph 2 are so multifarious that defendants are compelled to plead in respect to lines or parts thereof and therefore plead as follows:

(a) The defendants are without sufficient information to form a belief as to the relationships of the "selling directors" to Producers Life although they deny the implication that the phrase "selling directors" is an appropriate description of these persons.

(b) Defendants deny that there was anything contrary to the fiduciary obligations, if such there were, on the part of the "successor directors" as set forth in Lines 30 and 31 of page 3 and Line 1 of page 4.

(c) The defendants deny that the transaction was undertaken for the ultimate purpose of accomplishing the merger, etc., as set forth in Lines 3-8 of page 4, this being instead a subsequent development.

(d) The defendants admit that sales and transfers were made as set forth in Lines 11-15 of page 4.

(e) The defendants deny that there was any sale of directorships and offices or proxies as set forth in Lines 17-21 of page 4.

(f) The defendants admit the allegations of Lines 23-26 of page 4.

(g) The defendants admit the allegations of Lines 28-32 of page 4.

(h) The allegations of Lines 1-7 on page 5 are admitted.

(i) Lines 9 and 10 of page 5 are denied.

(j) It is denied that at the time of the transaction in question there was a plan of the sort specified in Lines 15-18, and the allegation that there was a so-called "scheme" on Line 18 of page 5 is especially denied as an offensive choice of words on the part of pleader.

(k) The allegations of Lines 20-23 on page 5 are denied, and all other allegations of paragraph 2 are denied.

3. The defendants admit that there were meetings on April 27, 1964 of the directors of National Securities and of Producers Life. These defendants have not sufficient information to form a belief as to whether there were or were not meetings of the directors of Dependable Life and Producers Thrift. All other allegations of paragraph 3 are denied.

4. The allegations of paragraph 4 are admitted and denied in accordance with the various admissions and denials of the preceding paragraphs to which this refers.

5. The allegations of paragraph 5 are denied as they are deliberately misleading and a palpably partial statement of the facts, there being substantial other consideration for the transfer in question, all of which is well known to the plaintiff; and the allegations as to market value are denied.

6. It is denied that National Securities "purported to assume" the obligations and direction, the fact being that they were assumed. The remaining allegations of paragraph 6 are denied.

7. It is admitted that a non-compete agreement was entered into between National Securities, Inc. and certain directors and their successors or assigns. It is denied that there was any provision as alleged for some emerging entity and it is further denied that there was any agreement with Dependable in this respect. The remainder of the paragraph is denied.

8. The allegations of paragraph 8 are denied, the fact being that National Securities agreed to pay \$942,769.41 for 66,400 shares, or an average of \$14.20 a share. No part of the agreement governed how this sum should be

allocated among the sellers and this was in fact of no concern to these defendants. \$57,230.59 was subsequently paid for 10,376 shares.

9. The allegations of paragraph 9 are denied, the fact being that National Securities agreed to pay \$942,769.41 for 66,400 shares, or an average of \$14.20 a share. No part of the agreement governed how this sum should be allocated among the sellers and this was in fact of no concern to these defendants. \$57,230.59 was subsequently paid for 10,376 shares.

10. It is admitted that the named persons did resign and that the other named persons were elected to the positions of directors and the allegations are otherwise denied.

11. It is admitted that Messrs. Saffert, and Large, were elected to the offices named and the allegations of paragraph 11 are otherwise denied.

12. The allegations of paragraph 12 are denied except that proxies were in fact substituted.

13. The allegations of paragraph 13 are denied except that an agreement was entered into.

14. It is admitted that the books and records were moved to the premises of National Life, in which offices have been maintained for Producers and the allegations are otherwise denied.

15. In regard to the allegations in paragraph 15, these defendants allege as follows:

The resignation of J. Grant Iverson was accepted by the Board of Directors of Producers Life on June 5, 1964; that the resignations of John J. Faleoner and Jess Hunter were accepted by that Board on May 28, 1964; that defendant Robert C. Bohannon, Jr. was appointed assistant secretary on May 28, 1964; that the defendant Ted Wilkins was appointed to the Board of Directors on June 5, 1964; that defendant Robert H. Wallace and Ron Larson were elected to the Board of Directors on November 27, 1964; that Mr. Robert Sampley was appointed to the Board of Directors on October 15, 1964. The allegations of paragraph 15 in conflict with the allegations herein are denied. The allegation in paragraph 15 regarding the duties of the defendant Bohannon is admitted.

16. The allegations of paragraph 16 are admitted.
17. The allegations of paragraph 17 are denied in that this plan was wholly independent of the action of April 27, 1964.
18. The defendants admit that on November 27, 1964 a consolidation agreement was in fact submitted to the stockholders of Producers Life along with a notice of meeting and a solicitation of proxies although they deny that this was in furtherance of any plan of April 27, 1964, it being independent thereof. These defendants decline to admit or deny as to the material set forth in lines 12-32 of paragraph 18, page 9, and lines 1-5 on page 10, the agreement which these lines purport to summarize being clearly the best evidence of its content. The defendants expressly deny that any matter has not been disclosed which should have been disclosed.
19. The allegations of paragraph 19 are admitted, the recess being subject to the call of the Chair on reasonable notice.
20. The allegations of paragraph 20 are denied insofar as they purport to attribute the activities therein contained to either National Securities or National Life, and it is further denied that the defendant Bohannon had any connection whatsoever with the meetings therein involved, all activities covered in this paragraph being those of Producers and its management. It is admitted that a notice was sent with the signatures alleged.
21. The defendants admit that a copy of the North Report was sent out with the proxy solicitation, this having been in all respects a proper and appropriate thing to do. They deny that this was in furtherance of the so-called "scheme and plan" for reasons previously set forth. They deny that the report was in any respect misleading as to their own connection with it, the report on its face making completely clear that the underlying information was obtained from these defendants. The North Report expressly stated that the "information contained in this report was obtained primarily from the company and sources close to the company and has not been otherwise verified although believed to be authentic." The statement as published contained a second express black-

bordered announcement by Producers putting the proper limitations upon any assurances made as to the North Report.

22. The allegations of paragraph 22 are denied.

AFFIRMATIVE DEFENSE

As an affirmative defense, if such it should be, these defendants allege:

1. There is pending a vote of the shareholders of Producers Life as to whether they wish to approve a merger with National Life.

2. The National Securities group owns approximately 15% of the stock of Producers Life. Under the laws of the State of Arizona, the vote of 66-2/3% of all of the outstanding stock of Producers would be required to approve the merger.

3. If the merger should not be approved, most of the issues involved in this injunction action will become moot. If it should be approved, the vote of a majority of the Producers shareholders other than the National Securities group will be required.

4. Nothing in any law administered by the plaintiff or in any regulation issued thereunder, bears upon any matter concerned in this purported merger vote by the two insurance companies.

Wherefore, it is prayed that the plaintiff take nothing by its complaint, and that the temporary restraining order issued herein be quashed, and that the complaint be dismissed.

Respectfully submitted,

LEWIS ROCA SCOVILLE
BEAUCHAMP & LINTON

By _____
JOHN P. FRANK

/s/ Jeremy Butler
JEREMY BUTLER

[Filed April 16, 1965]

AFFIDAVIT OF ROBERT H. WALLACE

3. At no time between March 15, 1964 and April 27, 1964 or at any other time, did he or any affiliated person or corporation conduct or carry on any negotiations with Messrs. Johnson, [2] Richards, Reedy or Bilbrey for merger of National Life with Producers Life.

[PARTIAL TRANSCRIPT OF PROCEEDINGS ON APPLICATION FOR PRELIMINARY INJUNCTION]

[15] THE COURT: * * * *

What they are going to do, as I understand it, they will probably hold this meeting and try to vote this stock and put through this matter, go over to the Insurance Commissioner. They have stipulated that any opponents will have a week. Isn't that it?

MR. FRANK: That's right, your Honor.

THE COURT: After the matter is approved by the stockholders, if it is approved?

MR. FRANK: Yea.

THE COURT: In which to apply to the Insurance Commissioner for a hearing before anything is done. And I assume that the minority stockholders, unless they are happy after all this, will probably go to the Insurance Commissioner, ask for a hearing, and then the wheels start to turn. And any time during the period, if the Commission is unhappy or feels that the public interest is not being served, I will be ready at any [16] time to hear you, on any notice practically. We will continue this matter for a further hearing, subject to application by any party, upon such notice as the rules fix, and upon such notice as the parties may stipulate, or upon such notice as the Court make take.

[19] MR. TUCKER: Let's say that in being confronted with this proposed stipulation, it is my understanding that Mr. Frank would interpret the order as if, in the form in which it would remain; amended by the changes that have been suggested, they would be at liberty to proceed to vote the proxies and would be at liberty to proceed to hold the meeting, they would be at liberty to proceed to take whatever further steps they contemplate to consummate the merger agreement; and if we were to come in—

THE COURT: They would be permitted to hold the meeting and to vote the proxies, and that the stockholders vote to approve the merger, to present it to the Insurance Commissioner for his approval or disapproval.

MR. FRANK: Your Honor, the stipulation—

[20] THE COURT: Beyond that, if there is any opposition, they could certainly make it known to the Director of Insurance, and all that machinery can be put in motion.

* * * *

[22] THE COURT: All right. I say that under my interpretation of it—I don't know how many times I must say it—under my interpretation of it, you can hold your meeting, you can vote your proxies, you can submit it to the Insurance Commissioner or Director of Insurance.

All right, now, are you going to say anything more in opposition to what you handed up to me here?

MR. FRANK: Your Honor, at that point we are indeed content.

* * * *

[50] THE COURT: Are you gentlemen leaving it for what is shown by the record with respect to the action of the Director of Insurance?

MR. TUCKER: I don't—

THE COURT: The agreement to withhold it for a week, and so forth? You are leaving that for what is shown on the record, I take it?

MR. TUCKER: I don't quite understand the thrust of your Honor's question.

THE COURT: It is not included in this motion and order, but it was agreed that the action of the Director

of Insurance—or the application will not be presented—How do you expect—

MR. FRANK: Your Honor, I had assured the Court earlier, and I accept with pleasure the courtesy of Mr. Tucker in taking my word for it on the record, that we shall not make application to the Director of Insurance to approve the merger under the statute, until at least a week after the matter is determined by the shareholders, if it is determined by the shareholders. And I have further said that I will give [51] telegraphic notice to Mr. Tucker, personally, at least a week in advance of our making such an application, so that he will be fully acquainted with any action we are taking in that regard.

MR. TUCKER: I think that counsel's assurances are entirely satisfactory to us, your Honor.

THE COURT: Very well. I am sure the record does show it, if not expressly, implicitly. But I am not ruling on the sufficiency or insufficiency of any proxy or of any action that has been taken or proposed to be taken, or as to the sufficiency of any notice of any meeting or of any continued meeting, or any of those matters.

MR. FRANK: It is fully understood, your Honor.

MR. TUCKER: It is understood, your Honor.

THE COURT: In other words, I don't want, for instance, any superior court judge to think that I am ruling on any of those matters, corporate procedural matters that might be presented to him upon a review of the Director of Insurance's order, or any of those matters.

As I recall, this meeting has been continued from time to time?

MR. FRANK: That's right. Your Honor, one other matter which I would like clear, if I may, as we [52] tidy the record, of exactly the sort we have been speaking of. We have during this extended argument indulged in many hypotheses as to possible fraud. I take it that we may rest assured that these are hypotheticals only, and that your Honor has not at any point meant to indicate that he was accepting either side's views as to the facts of the matter, and that no language should be taken out of context from this transcript indicating to the contrary.

THE COURT: I certainly didn't intend to—All that I am doing is lifting a partial restraint.

MR. FRANK: Yes. Very satisfactory.

THE COURT: Permitting things to happen if other people decide they are to happen, without any expression in any way of any opinion at all on the merits.

MR. FRANK: This is completely understood, and on behalf of our table we thank you for giving us what has been a very long day and a hard one.

THE COURT: It is a difficult matter. There may come a question, of course, before the Commissioner and before the state courts, perhaps, before I ever hear of this matter again, which involves, as I say, the validity of these proxies mentioned here, some of them, the validity of the contracts, procedure, corporate [53] procedures and other matters, notices of hearing, meetings.. I have not and do not intend at this time to express any opinion whatever.

[Entered April 16, 1965]

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA**

No. Civ. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRET, JOSEPH B. SETTER, BREEFERD W. LARGE, JR., RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM A. REEDY, BONNIE B. BILBREY, PRODUCERS LIFE INSURANCE COMPANY, a corporation, and PRODUCERS THRIFT & LOAN COMPANY, a corporation, DEFENDANTS

**ORDER AND JUDGMENT DROPPING
DEFENDANTS**

The Motions of defendants RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM P. REEDY, BON-

NIE B. BILBREY and PRODUCERS THRIFT & LOAN COMPANY, a corporation, to be dropped as defendants herein and to dismiss the complaint as to said defendants having come on regularly to be heard, and having been duly argued and the Court being fully advised in the premises;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that defendants RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM P. REEDY, BONNIE B. BILBREY and PRODUCERS THRIFT & LOAN COMPANY, a corporation, be and the same hereby are dropped from the above entitled action, and that the complaint herein be, and the same hereby is, dismissed, without prejudice and without prejudice to plaintiff's right to hereafter move to add the above-named defendants as defendants herein, as to defendants RICHARD G. JOHNSON, ERNEST A. RICHARDS, WILLIAM P. REEDY and BONNIE B. BILBREY, and PRODUCERS THRIFT & LOAN COMPANY, a corporation.

DATED this 16th day of April, 1965.

/s/ Wm. C. Mathes
U. S. District Judge

77
[Entered April 16, 1965]

**UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA**

No. Civ-5466-Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

vs.

**NATIONAL SECURITIES, INC., a corporation, et al,
DEFENDANTS**

MOTION AND ORDER

The Defendants National Securities, Inc., National Life & Casualty Insurance Company, Robert H. Wallace, Robert C. Bohannon, Jr., Arthur W. Saffert, Ted Wilkins, Don S. Barret, Joseph B. Setter, Breeferd W. Large, Jr., and Producers Life Insurance Company respectfully move this Court that the temporary restraining order previously entered in this cause be vacated except for the language following, which shall be kept in effect pending further hearing which may be instituted upon application of any of the parties. This continuance shall be without prejudice to the claims of any of the parties as to the jurisdiction of this Court or as to the applicable law. The portion of the restraining order to be continued in effect on this motion is as follows:

"IT IS ORDERED, ADJUDGED AND DECREED that said defendants, and each of them, their agents, attorneys, employees and assigns, and all persons acting in concert or participation with them, be and they are temporarily restrained and enjoined from, directly or indirectly—

"A. making use of any means or instrumentality of interstate commerce or of the mails to engage in any manipulative or deceptive device or contrivance, in violation of Section 10(b) of the Securities Exchange Act of 1934, 15.U.S.C. 78j(b), and Rule 10b-

5 thereunder, 17 CFR 240.10b-5, in connection with the purchase or sale of securities issued or to be issued by Producers Life in derogation of the rights and interests of the stockholders of Producers Life and in contravention of the fiduciary obligations of the defendants or any of them to Producers Life and its stockholders, a) by employing any device, scheme or artifice to defraud; b) by making any untrue statement of material fact or omitting to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or c) by engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon Producers Life or its stockholders."

Respectfully submitted,

LEWIS ROCA SCOVILLE
BEAUCHAMP & LINTON

By _____
JOHN P. FRANK

ORDER

The foregoing motion having been heard,

IT IS HEREWITH ORDERED that the temporary restraining order previously entered is vacated except as to the portions set forth in the motion, as to which it is continued pending further hearing which may be instituted upon application by any of the parties. This continuance shall be without prejudice to the claims of any of the parties as to the jurisdiction of this Court or as to the applicable law.

DONE IN OPEN COURT this 16th day of April, 1965.

/s/ William C. Mathes
District Judge

[Entered July 13, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. Civ. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL
LIFE & CASUALTY INSURANCE COMPANY, a corporation,
ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR.,
ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRET,
JOSEPH B. SETTER, BREEFERD W. LARGE, JR., and
PRODUCERS LIFE INSURANCE COMPANY, a corporation,
DEFENDANTS

ORDER ON MOTIONS PRESENTED JULY 12, 1965

This matter having come before the undersigned Judge sitting in the United States District Court for the District of Arizona, on the 12th day of July, 1965, at San Francisco, California, pursuant to stipulation, upon the

(1) Motion of the Securities and Exchange Commission for Reopening of Hearing on Motion for Preliminary Injunction and for Additional Relief Pendente Lite,

(2) Defendants' Motion to Dismiss plaintiff's complaint,

(3) Defendants' Motion to Strike Plaintiff's Motion for [2] Production of Documents for Inspection and Copying, and

(4) Motion of the Securities and Exchange Commission for Production of Documents Under Rule 34,

Plaintiff appearing through Mr. W. Stevens Tucker and Mr. James G. Newby, its attorneys, the defendants ap-

pearing through Mr. John P. Frank and Mr. Jeremy Butler, their attorneys, and the Court having received the statements of counsel and having considered the documents in the record and the proceedings before it, and

It having been stipulated that the Securities and Exchange Commission may file herein an amended and supplemental complaint within the period of thirty days from the date of this order and that the defendants may have a period of thirty days from receipt of a copy of such amended and supplemental complaint in which to respond thereto, and

It appearing that the parties also have stipulated for the production of the documents requested by the Securities and Exchange Commission, in accordance with the oral ruling of the Judge from the bench on July 12, 1965, and

The matters having been continued to and heard further on July 13, 1965, now therefore

IT IS ORDERED that:

(1) The Securities and Exchange Commission may serve and file its amended and supplemental complaint herein within thirty days from the date of this order,

(2) The defendants shall have a period of thirty days from the receipt of a copy of such amended and supplemental complaint in which to serve and file herein and serve any motion or other responsive matter,

[3] (3) The defendants' Motion for Dismissal of the Complaint and the Securities and Exchange Commission's Motion for Reopening Hearing on Preliminary Injunction and for Additional Relief Pendente Lite are both placed off calendar without prejudice to the right of either party to apply to the Court for reinstatement and consideration.

Dated July 13th, 1965.

/s/ Wm. C. Mathes
United States District Judge

[Filed August 12, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., a corporation, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a corporation, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR., and PRODUCERS LIFE INSURANCE COMPANY, a corporation (also known as NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS

AMENDED AND SUPPLEMENTAL COMPLAINT
FOR INJUNCTION

I

1. It appears to the Securities and Exchange Commission, plaintiff herein, that the defendants National Securities, Inc., a corporation ("National Securities"), National Life & Casualty Insurance Company, a corporation ("National Life"), Robert H. Wallace ("Wallace"), Robert C. Bohannon, Jr. ("Bohannon"), Arthur W. Saffert ("Saffert"), Ted Wilkins ("Wilkins"), John S. Barrett ("Barrett"), Joseph B. Setter ("Setter"), Breeferd W. Large, Jr. ("Large"), and Producers Life Insurance Company ("Producers Life"), a corporation, have engaged and are about to engage in acts and practices which constitute violations of Section 10(b) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5.

2. This action arises under Section 21(e) of the Act, 15 U.S.C. § 78u(e).

3. This Court has jurisdiction of this action under Section 27 of the Act, 15 U.S.C. § 78aa.

II

1. The defendant National Life is an Arizona corporation engaged in the life insurance business in Arizona and other western states.

2. The defendant National Securities is a Colorado corporation transacting business in Arizona as a holding company owning a majority of and the controlling interest in the stock of National Life.

3. At all times material hereto, the defendant Wallace has been president, chief executive officer and a director of National Securities and National Life; the defendant Bohannon has been executive vice-president of National Securities and National Life; the defendant Saffert has been employed by National Life as an actuary; and the defendants Wilkins, Barrett, Setter and Large have been employees of National Securities, or of National Life or of another subsidiary of National Securities, and subject to the direction and control of the defendant Wallace as principal executive officer of National Life and National Securities.

4. The defendant Producers Life is an Arizona corporation engaged in the life insurance business in Arizona and other western states. Since July 9, 1965, this corporation has been known as National Producers Life Insurance Company ("National Producers Life").

5. Prior to April 27, 1964, Richard G. Johnson ("Johnson"), Ernest A. Richards ("Richards"), William A. Reedy ("Reedy") and Bonnie B. Bilbrey ("Bilbrey"), sometimes hereinafter referred to as "selling directors", controlled and managed the business and affairs of Producers Life. They, together with J. Grant Iverson, Jess E. Hunter and John J. Falconer, made up the board of directors of Producers Life.

6. As of April 27, 1964, Producers Life had approximately 14,000 stockholders and 880,000 shares of common

stock issued and outstanding, including 50,208 treasury shares.

7. Prior to and on April 27, 1964, the selling directors owned in the aggregate 27,416 shares of the common stock of Producers Life. In addition, the selling directors controlled 88,904 shares of such stock which were held in the name of Producers Thrift & Loan Company ("Producers Thrift"), all of whose stock was owned by the selling directors and one other person.

8. Prior to and on April 27, 1964, the selling directors other than Bilbrey held voting proxies representing approximately 565,000 out of approximately 880,000 shares of the outstanding common stock of Producers Life.

III

1. Since March 15, 1964, the defendants, in concert with the selling directors, have made use of means and instrumentalities of interstate commerce and of the mails to engage in manipulative and deceptive devices and contrivances, in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and Rule 17 CFR 240.10b-5, in connection with the purchase and sale of securities issued and to be issued by Producers Life and National Life, a) by employing a device, scheme and artifice to defraud; b) by making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and c) by engaging in acts, practices and a course of business which operate and would operate as a fraud and deceit upon the defendant Producers Life and its stockholders, as more fully set forth below.

2. Since March 15, 1964, in derogation of the rights and interests of the stockholders of Producers Life, and in contravention of the fiduciary obligations of the selling directors to Producers Life and its stockholders, and contrary to the fiduciary obligations of the defendants Wallace, Saffert, Wilkins, Barrett, and Large, sometimes hereinafter referred to as "successor directors," to Producers Life and its stockholders, the defendants with the objective of transferring control of and dominion over the

assets, business (including insurance in force) and other resources of Producers Life to National Life and National Securities, and with the ultimate objective of accomplishing a merger, consolidation or amalgamation of Producers Life and National Life (with the surviving corporation to be subject to the dominion and control of the defendant National Securities and its nominees), have conducted negotiations and effected arrangements including the following:

- (a) the sale and transfer of the stock of Producers Life owned by the selling directors, by Producers Thrift and by Producers Life ("treasury stock") to National Life or National Securities;
- (b) the sale, surrender and transfer by the selling directors to National Life or National Securities and their designees of their directorships and offices in Producers Life, together with the voting proxies of ordinary stockholders held by them;
- (c) the acquisition by the selling director Reedy and his nominees from Producers Life of 111,088 shares of the Class A stock and 1,469 shares of the Class B stock of Dependable Life Insurance Company ("Dependable") owned by Producers Life;
- (d) the acquisition by Producers Thrift of 40,000 shares of its preferred stock, \$100,479 of its promissory notes and assigned collateral and 25,248 shares of the stock of Producers Finance Company of Arizona owned by Producers Life;
- (e) the execution of agreements under which the selling directors are to receive \$979,000 from National Securities for their agreements not to compete in the insurance business and the assumption by National Securities of pre-existing obligations of Producers Life to certain other persons under similar agreements; and
- (f) the consolidation of all of the business operations of Producers Life into those of National Life;

and the defendants, acting in concert with the selling directors, have accomplished the following additional elements of their scheme and plan:

- (g) the merger and consolidation of Producers Life and National Life by means of purchases and sales of securities through an agreement of consolidation and plan of reorganization;
- (h) the acquisition of complete dominion over and control by National Life and National Securities, their officers, directors and nominees, of all assets, business and affairs of Producers Life.

3. On or about April 27, 1964, the individual defendants and the selling directors in their respective capacities as directors of National Securities, of Producers Life, of Dependable Life and of Producers Thrift met in Phoenix, Arizona, to authorize the corporate actions necessary to put the foregoing plan and scheme into operation.

4. On or about April 27, 1964, pursuant to actions taken by their directors, the defendants National Life, National Securities, Producers Life and Producers Thrift and the selling directors entered into and performed an escrow agreement which, by means of the documents, moneys and securities passing through said escrow, accomplished the purposes of Items (a), (b), (c), (d) and (e) of paragraph 2 hereof.

5. The selling directors, in furtherance of the plan and scheme, caused Producers Life to transfer to National Securities through said escrow 50,203 shares of the treasury stock of Producers Life for a stated consideration of \$114,964.87 in cash or securities (equivalent to \$2.29 per share, the then book value of said stock) at a time when the market price for said stock on the over-the-counter market was approximately 7½ bid, 8 asked and National Securities purported to assume certain obligations of Producers Life and Dependable in favor of persons named Pound, Lovelace, Heeder and Davis in the amount of \$627,891.28 as an additional consideration for the purchase of the 50,203 shares of Producers Life as described above. It was intended by the defendants, however, that National Securities and National Life, after assuming dominion over and control of Producers Life, would by some means cause Producers Life, or the surviving corporation resulting from the contemplated merger or con-

solidation of Producers Life and National Life, to reimburse National Securities for moneys paid out pursuant to its assumption of such obligations.

6. On or about April 27, 1964, as an incident of the escrow described in paragraph 4 hereof, and in furtherance of defendants' plan and scheme, National Securities and the selling directors executed and exchanged agreements by which the selling directors and Dependable agreed (with some limitations) not to compete in the insurance business with Producers Life and National Life or any entity emerging from the contemplated merger or consolidation of those corporate defendants, and National Securities agreed to compensate the selling directors in an aggregate amount of \$979,000 payable in 120 monthly installments following April 30, 1964. As an element of said scheme and plan, it was intended by the defendants that National Securities and National Life, after assuming dominion over and control of Producers Life, would cause Producers Life, or the corporation surviving from said merger or consolidation, to reimburse National Securities for moneys paid out pursuant to said "non-compete" agreements.

7. On or about April 27, 1964, in furtherance of said scheme and plan, the selling directors received approximately \$570,000 from National Securities through said escrow as consideration for their 27,416 shares of the stock of Producers Life, which sum is equivalent to \$20.79 per share.

8. On or about April 27, 1964, in furtherance of said scheme and plan, the selling directors caused Producers Thrift, which they owned and controlled, to sell through said escrow to National Securities 38,894 shares of the stock of Producers Life for an aggregate consideration of \$372,769.41, or approximately \$9.00 per share.

9. On or about April 27, 1964, in furtherance of said scheme and plan, at a meeting of the directors of Producers Life, the selling directors resigned their positions as officers and directors of Producers Life, one by one, and caused the remaining directors to elect, in their stead as directors, nominees of National Securities and National Life, namely, the defendants Saffert, Barrett, Setter and

Large, who thereupon assumed management and control of the assets, business and affairs of Producers Life.

10. On or about April 27, 1964, in furtherance of said plan and scheme, the defendants Saffert, Barrett, Setter and Large, then constituting a majority of the board of directors of Producers Life (called the "new board"), forthwith caused the election of defendant Saffert as president and of defendant Large as secretary of said corporation.

11. On or about April 27, 1964, in order to cement the dominion and control over Producers Life by National Securities and National Life, and their agents and nominees, and in furtherance of said scheme and plan, the selling directors other than Bilbrey transferred through said escrow to the defendant Wallace voting proxies representing in excess of 60 per cent of the then outstanding stock of Producers Life, together with documents of assignment and substitution.

12. The selling directors, in carrying out and executing the transactions described above, and thereby enriching themselves, were acting in concert with the defendants and in contravention of their fiduciary obligations to the stockholders of Producers Life as a group, and such selling directors knew or should have known that the defendants were engaged in accomplishing a device and scheme to effect a merger or consolidation of Producers Life and National Life for the benefit and advantage of National Securities or to accomplish some other similar arrangement for the benefit and advantage of National Securities.

13. On or about April 27, 1964, as a further incident of said scheme and plan, the new board of directors of Producers Life forthwith caused its officers Saffert and Large to execute a "Management Agreement" between Producers Life and National Securities under which National Securities assumed full and complete management of the business and affairs of Producers Life.

14. Shortly after April 27, 1964, all of the books, records and business operations of Producers Life were removed to the premises of National Life and blended into the operations of National Life, the offices of Producers

Life were closed and its affairs since have been conducted in the offices of National Life.

15. In May, 1964, the 116,603 shares of Producers Life acquired by National Securities through the escrow referred to in paragraph 4 hereof, and certain additional shares, were transferred to National Life, for a consideration represented to be \$1,114,964.87.

16. The remaining minority directors of Producers Life resigned as follows: Messrs. Falconer and Hunter in May, 1964, and Mr. Iverpon in June, 1964. In furtherance of said scheme and plan the board of directors of Producers Life appointed as directors to fill vacancies the following: on June 5, 1964, Ted E. Wilkins; on October 15, 1964, Robert Sampley; on November 27, 1964, Robert M. Wallace (president and a director of National Securities; president and a director of National Life) and Ronald G. Larson (a director of National Life). Joseph C. Shorrocks (a vice-president and a director of National Life and of National Securities) was elected a director at a stockholders' meeting held December 31, 1964 through the vote of 135,038 shares of the stock of Producers Life held by National Life and through the voting of additional shares represented by proxies held and voted by Wallace and Saffert. The defendants who have knowledge of the number of shares represented and voted at said meeting by proxies obtained by defendant Wallace from the selling directors on April 27, 1964, as alleged in paragraph 11, and of the number of shares then represented and voted by means of proxies obtained by means of the proxy solicitations described in paragraphs 18 through 26, have refused to reveal this information.

17. On May 28, 1964, the board of directors of Producers Life elected defendant Bohannon (executive vice-president and a director of National Securities and treasurer and a director of National Life) as assistant secretary with specific powers respecting transactions in the stocks, bonds and other securities in its portfolio.

18. The directors of Producers Life who were selected as described in paragraphs 9 and 16 at all times since their selection have served, and continue to serve, as directors of Producers Life and have used their positions

and offices to facilitate and accomplish the device, scheme and artifice to defraud and the acts, practices and course of business as alleged herein. Whenever the term "National Group" is used below it signifies the defendants National Securities, National Life and the individual defendants Wallace, Bohannon, Saffert, Wilkins, Barrott, Setter and Large.

19. Commencing in August, 1964, and continuing thereafter through March, 1965, the National Group through its designee directors of Producers Life and officers and employees selected by them, in furtherance of said scheme and plan, conducted an intensive campaign through communications sent by means of the mails to the 14,000 public stockholders of Producers Life throughout the United States. These communications were drafted and designed to convince the stockholders of the business abilities of the National Group, to belittle and discredit any stockholders opposed to their plans and actions, and to solicit the execution of proxies which would authorize the defendants Wallace and Saffert, with full powers of substitution, to vote shares of such stockholders at any meetings of the stockholders. These communications contained misrepresentations of material facts and omitted to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they were made, not misleading, including the communications, statements and omissions described in paragraphs 21 through 34 below.

20. On or about November 27, 1964, in furtherance of said scheme and plan, the defendants National Life and Producers Life entered into an agreement to consolidate and reorganize. This agreement was authorized on behalf of Producers Life by its board of directors, all of whom were nominees of National Securities. The agreement provides, *inter alia*, for the merger of National Life into Producers, the termination of the management agreement (described in paragraph 13 hereof), a reorganization of Producers Life and the issuance of shares of Producers Life in exchange for outstanding shares of National Life, the change of the name of Producers Life to National

Producers Life Insurance Company ("National Producers"), and an undertaking by Producers Life and National Life that National Producers will reimburse National Securities for all sums expended by National Securities on account of its obligations (a) pursuant to the "non-compete" agreements executed in favor of the selling directors other than Bilbrey as described in paragraph 7 hereof, and (b) pursuant to its assumption of the obligations of Producers Life under the "non-compete" agreements in favor of Messrs. Pound, Lovelace, Heeder and Davis as described in paragraph 6 hereof. In addition, the agreement to consolidate and reorganize provides for its submission to the stockholders of Producers Life and National Life for their approval. A true and complete copy of said agreement to consolidate and reorganize is included in Exhibit 9(2)¹ hereto attached and incorporated herein by reference.

21. On or about November 27, 1964, in furtherance of said scheme and plan, the National Group caused to be mailed to the stockholders of Producers Life throughout the United States copies of the consolidation agreement dated November 27, 1964, together with copies of the notice of special meeting of stockholders to be held on December 31, 1964, and other material soliciting proxies to the defendants Saffert and Wallace to be voted in favor of the consolidation agreement. The said proxy solicitation material consisted of a Notice of Special Meeting of Stockholders to be held on December 31, 1964, and a copy of the consolidation agreement, true copies of which are attached hereto as Exhibit 9(1) and 9(2), respectively, a letter to stockholders dated November 27, 1964 over the signature of A. W. Saffert and a form of proxy, true copies of which are hereto attached as Exhibit 10(1) and 10(2), respectively.

22. The consolidation agreement Exhibit 9(2) provides in paragraph 24 that Producers Life (to be renamed National Producers Life Insurance Company), as the surviv-

¹ The Exhibits appended hereto are numbered to conform with the same Exhibits which are attached to the affidavit of W. S. Tucker heretofore filed in this action.

ing corporation upon consummation of the agreement, is to reimburse National Securities (and charge to expense) any sums paid by National Securities on account of the "non-compete" agreements of April 27, 1964, with the selling directors, but nowhere in such proxy solicitation material or otherwise has the National Group disclosed to stockholders of Producers Life that the sums so to be paid to National Securities amount to about \$97,900 per year for more than nine years and total in excess of \$983,000.

23. The consolidation agreement provides in paragraph 24 that the surviving corporation will reimburse National Securities for (and charge to expense) any sums paid out by National Securities by reason of its assumption on April 27, 1964, of the obligations of Producers Life to Messrs. Pound, Lovelace, Heeder and Davis for their agreements not to compete in the insurance business, but the National Group has failed to disclose to stockholders of Producers Life in such proxy solicitation material or otherwise (1) that the amount so to be paid is approximately \$511,695; and (2) that the effect of the provision of the consolidation agreement would be to relieve National Securities from, and transfer to the survivor of the proposed consolidation of Producers Life and National Life, the obligations to Messrs. Pound, Lovelace, Heeder and Davis which National Securities had assumed and for which it received a credit of \$627,891.76 on the stated purchase price of \$742,850.63 which it paid on April 27, 1964, for the 50,203 shares of stock of Producers Life bought from Producers Life as described in paragraphs 5 and 6 of Part III hereof.

24. The Notice of Special Meeting of Stockholders, Exhibit 9(1), mailed as alleged in paragraph 19 hereof provides that at the special meeting convened for December 31, 1964, there would be a vote of stockholders upon:

"4. The approval of a resolution adopted by the Board of Directors amending the Bylaws by increasing its size to nine members and providing in part that the terms of Directors shall be three years with the terms of three Directors expiring each year."

As part of said scheme and plan, the National Group failed to disclose in the proxy solicitation material (Exhibits 9 and 10) or elsewhere that (1) it was the intention of the National Group to cause the adoption of a resolution which not only contained the foregoing provisions but also would amend the by-laws so that, with respect to the removal of directors, a two-thirds majority vote by all stockholders entitled to vote on such removal would be required in order to remove the board as a whole and no director could be removed if the votes cast against his removal would be sufficient to elect him if then cumulatively voted at an election of the entire board of directors; (2) including the proxies acquired from the selling directors, the National Group then had sufficient proxies to pass the resolution described in clause (1); (3) National Securities then owned and controlled sufficient voting shares to effectively block the removal of any director under the terms of the amended by-law; (4) the true purpose of the resolution as a whole was to make absolute the control and domination of Producers Life (also National Producers Life) by National Securities through its nominees acting as directors and officers thereof, and to prevent any effective interference with such domination and control by or on behalf of any of the public stockholders of Producers Life (also National Producers Life).

25. Nowhere in the communications (Exhibits 9 and 10) or elsewhere did the National Group disclose to stockholders of Producers Life that (1) under Arizona law stockholders who voted to reject the consolidation agreement, and who did not consent to the agreed manner of converting the shares of stock, had the right to be paid in cash the fair value of their stock provided that they gave written notice of dissent to Producers Life not later than two days after the meeting to vote upon the consolidation agreement; or that (2) in order to secure dissenters' rights under the laws of Arizona it was necessary that a stockholder affirmatively vote against the proposed merger or consolidation of National Life and Producers Life.

26. The form of proxy provided by the National Group for the use of stockholders, Exhibit 10(2), purports to appoint A. W. Saffert and R. H. Wallace, or either of them, with power of substitution, as proxies to vote the solicited stockholders' shares in Producers Life or National Producers:

"1. At the special meeting of stockholders or adjournments or recesses thereof held for the approval of a Consolidation Agreement between Producers Life Insurance Company and National Life & Casualty Company providing for the merger of National into Producers which would be thenceforth known as 'National Producers Life Insurance Company'"; and

"2. At any other meeting of the stockholders of Producers or National Producers, and at all adjournments or recesses thereof."

The communications to stockholders did not disclose the rights of dissenters under Arizona law, and the form of proxy (1) afforded no means whereby the stockholders who were so solicited could vote against the proposed merger or consolidation and thereby secure their rights as dissenters in accordance with Arizona law; and (2) afforded the stockholders so solicited no means whereby they could vote separately on any of the several matters presented for action at the proposed special meeting of stockholders.

27. In furtherance of said scheme and plan, the balance sheet of National Life included in the solicitation material (Exhibit 10(1)) includes 130,506 shares of the stock of Producers Life shown as an asset in the sum of \$1,174,556, equivalent to \$9 per share. The consolidation agreement (Exhibit 9(2)) provides in paragraph 8 that—

"On the final effective date, but nevertheless for all purposes whatsoever as of December 31, 1964, regardless of the actual date, Producers, the surviving corporation, shall become the owner of all of the assets and assume all liabilities of National Life, including policy liabilities, all as of December 31, 1964, and National Life shall cease to exist as a corporate entity."

Exhibit 10(1) also contains a *pro forma* balance sheet of National Producers Life, giving effect to the consolidation, as of June 30, 1964. The *pro forma* balance sheet includes treasury stock in the amount of \$1,174,556, as an investment asset, reflecting the conversion of the shares of Producers Life held by National Life at June 30, 1964, into shares of National Producers Life. Nowhere in these balance sheets (Exhibit 10(1)) or elsewhere has the National Group disclosed to stockholders of Producers Life that the market value of the stock of Producers Life on and about June 30, 1964, was less than \$6.75 per share or that on and about November 27, 1964, said market value was less than \$6.75 per share. The inclusion of treasury stock as an investment asset at a valuation of \$1,174,556 or any other sum in said *pro forma* balance sheet was *per se* misleading in that such treasury stock constituted a fictitious and illusory asset, and was no different from authorized but unissued stock except that it could be sold for less than par (in this case fifty cents per share).

28. As part of said scheme and plan the National Group caused to be included within the solicitation material (Exhibits 9 and 10) and also those alleged below in paragraphs 31 and 32 positive forecasts that the net income before taxes for the reorganized National Producers Life for the calendar year 1965 would be \$460,000. These representations are *per se* misleading in that there can be no assurance that such net income or any part thereof will be realized.

29. The meeting noticed as provided in Exhibit 9(1) was convened on December 31, 1964. Action was then taken to elect Joseph C. Shorrock as a director as alleged in paragraph 16 above and to adopt the amendment to the by-laws referred to in paragraph 24. The meeting was then recessed *sine die* without a vote on the proposed merger or consolidation.

30. In furtherance of said scheme and plan the National Group acting through defendants Saffert and Large arranged for the recessed meeting referred to in paragraph 26 to be reconvened on March 26, 1965, at Phoenix,

Arizona. The meeting was further recessed on March 26, 1965, and eventually was held on or about April 19, 1965, or April 26, 1965, or on both such days.

31. On or about March 2, 1965, in furtherance of said scheme and plan, the defendants caused to be mailed to stockholders of Producers Life a communication (over the signature of the defendant Saffert) soliciting proxies to be voted in favor of the proposed consolidation agreement and plan of reorganization with which was enclosed a copy of an investment advisory letter entitled "North's News Letter and Special Report" dated February 9, 1964. The "Special Report" although purporting to be an analysis by an independent investment advisory service of the financial affairs of National Securities and its subsidiaries, including National Life and Producers Life, and of the effect of the proposed merger and consolidation, in fact represented nothing more than an assemblage of statistics, projections, formulas and conclusions which were provided by the management of National Securities and were based on the information contained in Exhibits 9 and 10. The "Special Report" did not, in any true sense, represent an independent analysis of National Securities by the advisory service.

32. On March 13, 1965, the defendants caused a notice of the reconvening on March 26, 1965, of the recessed stockholders' meeting to be mailed (over the signature of the defendant Large) to stockholders of Producers Life, together with a communication (over the signature of the defendant Saffert) soliciting proxies in favor of the existing management to be voted in favor of the consolidation agreement and plan of reorganization described in paragraph 20 hereof.

33. In furtherance of said scheme and plan, none of the communications mailed to stockholders of Producers Life as described herein disclosed the following material facts necessary in order to make the statements made therein not misleading:

- (a) during the fiscal year ended December 31, 1964, a net operating loss of \$35,657 had been sustained by National Life and a net operating loss of \$69,716 had been sustained by Producers Life;

- (b) shares of capital stock of Producers Life acquired by National Life at a stated cost in excess of \$1,184,000 had been written down on the books of National Life to \$641,658, the approximate market value of said stock as of December 31, 1964, with a resulting reduction of the surplus account of National Life in the sum of \$579,881.16;
- (c) market value of shares of Producers Life was less than \$6.75 on or about December 31, 1964, less than \$7.08 on or about March 2, 1965, and less than \$7.88 on or about March 18, 1965.

34. On or about May 8, 1965, the National Group caused to be sent by mail to stockholders of Producers Life throughout the United States a communication on the letterhead of Producers Life over the signature of A. W. Saffert, which contained the following statements:

"The merger of National Life and Casualty Insurance Company into Producers Life Insurance Company has been approved by stockholders of both companies, and is now ready for submission to the Arizona Director of Insurance for final approval. His decision is expected soon.

"Stockholders of Producers Life cast 661,497 votes in favor of the merger at the April 16 recessed meeting. This was 75% of the outstanding shares and represented an overwhelming approval of this issue which had been debated for several months. This action was later confirmed at the regularly scheduled meeting of April 26 by the affirmative vote of 692,212 shares, which is 78% of the total outstanding.

"By the same vote, stockholders approved a resolution calling for a 6-for-5 stock split. Upon approval of the merger by the Arizona Director of Insurance this will mean you will have six shares of stock in the merged company for every five shares you now own in Producers Life."

"The way was cleared for the merger vote by two court decisions. First, the Superior Court granted our motion to set aside a previous order which prevented a vote by Producers Life stockholders. Then, the Federal District Court granted our motion to vacate an order previously obtained by the SEC which had barred voting on the merger proposal."

This communication did not disclose that the Court, in vacating the order previously entered which barred the voting of proxies obtained by the defendants Wallace and Saffert, also entered an order restraining the defendants from engaging in any manipulative or deceptive device or contrivance, in violation of Section 10(b) of the Act, 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5, "in connection with the purchase or sale of securities issued or to be issued by Producers Life in derogation of the rights and interests of the stockholders of Producers Life and in contravention of the fiduciary obligations of the defendants or any of them to Producers Life and its stockholders . . .," and that the merits of the allegations made by the Commission remained for determination by the Court after trial.

35. Slightly over 15% of the 75% (and 78%) of the outstanding shares of stock referred to in the communication quoted above was accounted for by more than 135,000 shares owned by National Securities, of which 13.3% was acquired from and through the selling directors as alleged in paragraphs 5 through 8 hereof. The balance of the shares voted (slightly under 60% (and 63%)) was accounted for by proxies given to and voted by the defendants Wallace and Saffert (or their substitutes) which had been obtained by means of the acts of fraud and deceit alleged in paragraphs 21 through 33 hereof.

36. The Consolidation Agreement of November 27, 1964, is void and ineffective because (1) it represents an essential element of an unlawful scheme and device to defraud, and (2) it has never been given valid approval by the holders of the requisite two-thirds majority of the outstanding stock of Producers Life.

37. The Consolidation Agreement of November 27, 1964, and the provision for a one-for-five stock dividend

to stockholders of Producers Life were submitted to the Director of Insurance of the State of Arizona on May 7, 1965, for his approval. On July 9, 1965, the Director announced his approval of the stock dividend and of the agreement, and the defendants then announced that they had accomplished all formal acts required to consummate the consolidation agreement.

38. The National Group is proceeding to combine and intermingle the business, insurance, records, assets, liabilities and all affairs of National Life and Producers Life into a single integrated operation, and is ceasing to maintain the separate corporate and business identities of the two corporations.

The defendants, unless restrained and enjoined, will continue to engage in the acts and practices specified above.

WHEREFORE, the Securities and Exchange Commission demands:

1. That the Court determine and adjudicate that the occurrences described in Section III above constituted a device, scheme and artifice to defraud and a series of acts, practices and a course of business, in connection with the purchase and sale of securities, which were accomplished by the defendants in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5.

2. That a preliminary injunction and a permanent injunction be entered restraining and enjoining the defendants and each of them, their officers, agents, employees, attorneys, successors and assigns, and all persons acting in concert or participation with them, from, directly or indirectly, making use of any means or instrumentality of interstate commerce or of the mails to engage in any manipulative or deceptive device or contrivance, in violation of Section 10(b) of the Act, 15 U.S.C. § 78j(b), and

Rule 17 CFR 240.10b-5, in connection with the purchase or sale of any securities, a) by making any untrue statement of material fact or omitting to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or b) by engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, whether through--

- (1) the device of a plan of reorganization, consolidation, merger, management contract or otherwise; or
- (2) the solicitation of voting proxies or votes of stockholders to be used to accomplish any such plan of reorganization, consolidation or merger;

or engaging in any act, practice or course of business of similar object or purport.

3. That the Court enter a decree requiring and compelling the defendants and each of them to take all actions and measures which are necessary to rectify and correct the consequences of the wrongful and unlawful conduct of defendants as specified above and to restore Producers Life, National Life, their stockholders and the defendants to the status and economic condition which they occupied prior to April 27, 1964.

4. That the Court enter a decree requiring and compelling the defendants and each of them to make an accounting of the extent to which their actions and the actions of the selling directors in violation of Section 10(b) of the Act, 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5, and in derogation of the rights and interests of the stockholders of Producers Life, have resulted in damage to such stockholders, and the extent to which the defendants have been unjustly enriched at the expense of such stockholders; and that, by suitable decree of the Court, the respective equities of the defendants and the stockholders of Producers Life be arranged and adjusted on a fair and equitable basis, including, if warranted on the basis of the accountings made by the defendants, the subordination of the stock interests and other equities of National Securities in National Producers to the interests

of those stockholders whose equities have been diminished by reason of the unlawful and wrongful conduct of the defendants.

5. That the Commission may have all further relief that the Court may deem just, equitable, and necessary in the circumstances.

/s/ Arthur E. Pennekamp
ARTHUR E. PENNEKAMP
Regional Administrator

/s/ W. Stevens Tucker
W. STEVENS TUCKER
Assistant Regional Administrator

/s/ F. E. Kennamer, Jr.
F. E. KENNAMER, JR.
Assistant General Counsel

/s/ James G. Newby
JAMES G. NEWBY
Attorney
Securities and Exchange Commission

[Filed September 1, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. Civ. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., ET AL., DEFENDANTS

ANSWER OF DEFENDANTS TO AMENDED
AND SUPPLEMENTAL COMPLAINT

For its answer to the complaint in this cause, the defendants answer as follows:

1. This Court has no jurisdiction of this matter, the matter complained of not being within any jurisdiction given to the Court under the Securities Act of 1934.

2. This Court further has no jurisdiction because the matters complained of are entirely within state jurisdiction, as provided by the McCarran Act, 15 U.S.C. Sec. 1012(b).

3. There is an absence of indispensable parties.

4. The complaint fails to state a claim for relief.

In addition, the defendants, for further answer, following the written numbers of the complaint herein, answer as follows:

I

1. The allegations of paragraph 1 are denied.
2. The allegations of paragraph 2 are denied.
3. The allegations of paragraph 3 are denied.

II

1. The allegations of paragraph 1 are denied, the defendant National Life having merged into another company now known as National Producers Life Insurance Company.

2. The allegations of paragraph 2 are denied.

3. The allegations of paragraph 3 are denied as to National Life, that company having been merged as is set forth in paragraph 1 hereof. The allegations as to direction and control are denied. The allegations as to the employment of Wilkins are denied.

4. The allegations of paragraph 4 are admitted.

5. The allegations of paragraph 5 as to the composition of the Board of Producers are admitted and the defendants, not having sufficient information to form a belief, deny the allegations as to control and management.

6. The allegations as to paragraph 6 are admitted.

7. The allegations of paragraph 7 are admitted insofar as the number of shares owned by the named persons. As to the "control" of the shares of Producers Thrift, this relates to the internal management of this corporation and these defendants have not sufficient information or belief to plead thereto. However, it is believed that the number of shares to which the plaintiff meant to make reference was 38,984 instead of 38,904 as pleaded.

8. The allegations of paragraph 8 are admitted.

III

1. The allegations of paragraph 1 are denied in each and every particular.

2. The allegations of paragraph 2 are so multifarious that defendants are compelled to plead in respect to lines or parts thereof. The portions in lines 1-13 are denied, and otherwise the defendants respond as follows:

(a) The defendants admit that the stock identified in paragraph 2(a) was sold to these purchasers and otherwise deny the allegations of the paragraph.

(b) The allegations of this subparagraph are denied.

(c) The allegations of this subparagraph are admitted insofar as it alleges that the person or persons referred to purchased the stock in question.

(d) The allegations of this subparagraph are admitted insofar as it is descriptive of the transaction.

(e) The allegations of this subparagraph are admitted insofar as it is descriptive of the transaction.

(f) The allegations of this subparagraph are denied as to the period prior to the merger; and by the merger, National Life was "merged" into Producers Life.

(g) Defendants admit that Producers Life and National Life have been merged.

(h) The allegations of this subparagraph are denied.

3. The allegations of this paragraph are denied.

4. Defendants admit that on April 27, 1964, a transaction was entered into but deny that this was for or accomplished the purposes attributed thereto.

5. The allegations of paragraph 5 are denied, apart from all other inaccuracies National Securities having in fact paid \$127,559.70 without reimbursement from anyone on the obligations alluded to in this paragraph in the year 1964.

6. The allegations of paragraph 6 are denied.

7. The allegations of paragraph 7 are denied, the fact being that National Securities agreed to pay \$942,769.41 for 66,400 shares, or an average of \$14.20 a share. No part of the agreement governed how this sum should be allocated among the sellers and this was in fact of no concern to these defendants.

8. The allegations of paragraph 8 are denied, the fact being that National Securities agreed to pay \$942,769.41 for 66,400 shares, or an average of \$14.20 a share. No part of the agreement governed how this sum should be allocated among the sellers and this was in fact of no concern to these defendants.

9. It is admitted that the named persons did resign and that the other named persons were elected to the positions of directors and the allegations are otherwise denied.

10. It is admitted that Messrs. Saffert and Large were elected to the offices named and the allegations of paragraph 10 are otherwise denied.

11. The allegations of paragraph 11 are denied except that proxies were in fact substituted.

12. The allegations of paragraph 12 are denied.

13. The allegations of paragraph 13 are denied except that a management agreement was entered into.

14. Defendants admit that the books and records were moved to a building in which National Life and several

other concerns have offices, and in which offices have been maintained for Producers; and the allegations are otherwise denied.

15. The allegations of paragraph 15 are admitted.

16. In regard to the allegations in paragraph 16, the defendants allege as follows:

The resignation of J. Grant Iverson was accepted by the Board of Directors of Producers Life on June 5, 1964; the resignations of John J. Falconer and Jess Hunter were accepted by that Board on May 28, 1964; the defendant Ted Wilkins was appointed to the Board of Directors on June 5, 1964; defendant Robert H. Wallace and Ron Larson were elected to the Board of Directors on November 27, 1964; Mr. Robert Sampley was appointed to the Board of Directors on October 15, 1964. The allegations of paragraph 16 in conflict with the allegations herein are denied.

17. The allegations of paragraph 17 are admitted.

18. The allegations of paragraph 18 are denied.

19. The defendants admit that from the period of approximately August 1964 to approximately March 1965, there was a vigorous shareholders fight within Producers and that those favorable to and those opposed to management did wage an intensive campaign among the stockholders. Proxies were solicited on all sides and this included solicitation of proxies to be given to the defendants Wallace and Saffert. Defendants deny that any such communications issued by them contained any misrepresentations of material facts or omissions of matters necessary to be stated in order to avoid misleading and instead allege, that, considering the tempestuous nature of the battle under way, the various statements issued by these defendants or persons in concert with them were singularly trustworthy.

20. The defendants admit that a general plan to consolidate and reorganize by a statutory merger was entered into by National and Producers. As to the various terms of these compendious agreements, defendants decline to admit or deny, the documents being the best evidence of their terms. They admit that the agreement provided for submission to the stockholders of the two companies and otherwise deny the allegations of the complaint.

21. Defendants admit that the various mailings attributed to them were made and deny the remainder of the allegations of this paragraph.

22. Defendants neither admit nor deny the allegations of this paragraph, the allegations being simply a purported summary of the terms of an exhibit attached to the amended complaint. The allegations as a summary are partial only, the Commission omitting to state material facts necessary to be stated in order to make its own statements made, in the light of the circumstances under which they were made, not misleading, in that the Commission fails expressly to note the various contingencies and reservations as to the commitment here baldly alleged. The dollar figure is correct.

23. Defendants make the same answer to this paragraph as to paragraph 22.

24. The allegations of paragraph 24 are admitted insofar as they purport to quote the notice of special meeting of stockholders and the paragraph is otherwise denied.

25. The allegations of paragraph 25 are denied, the defendants having expressly referred to the applicable statutes. If the substance of the allegation is that the defendants did not attempt to interpret the various applicable Arizona merger statutes, the allegation is admitted and defendants further allege that this is both the general and the better practice.

26. Defendants admit that it solicited general proxies and allege further that the solicitations were made in the context of the general proxy fight in which two other groups were seeking negative votes.

27. The allegations of paragraph 27 are denied and it is affirmatively alleged that the figure used was substantially similar to that authorized expressly by the Insurance Commissioner of Arizona in writing for this general purpose. The inclusion of Treasury stock as an investment asset was not per se misleading and was here permissible under generally accepted accounting practices.

28. The allegations of this paragraph insofar as they allege misleading statements are denied.

29. The allegations of paragraph 29 are admitted, the defendants affirmatively alleging that the filing of an ad-

ditional lawsuit shortly before the December 31 meeting made it appear unwise to vote on the merger matter at that time without obtaining advice of counsel.

30. The defendants admit the series of meetings referred to in paragraph 30 and otherwise deny the allegations of this paragraph.

31. The defendants admit that a document such as that identified in paragraph 31 was distributed and otherwise deny the allegations. The report on its face made completely clear that the underlying information was obtained from these defendants, expressly stating that the "information contained in this report was obtained primarily from the company and sources close to the company and has not been otherwise verified although believed to be authentic." The statement as published contained a second express black-bordered announcement by Producers putting the proper limitations upon any assurances made as to the North Report.

32. The allegations of paragraph 31 are admitted.

33. Defendants deny that any of the matters referred to needed to be disclosed in order to avoid having the statements in question materially misleading. They affirmatively allege that all treatments of the problem of value for purposes of the merger were on the basis of book rather than market.

34. For answer to this paragraph, the defendants allege that the materials circulated over the signature of Mr. Saffert was in all respects true and correct. The allegations by the plaintiff herein are themselves seriously misleading in that they fail to advise this Court that the Court previously had vacated after argument all portions of a previously obtained ex parte restraining order which precluded the merger.

35. The defendants deny the allegations of this paragraph and allege that well over 60% of the stockholders' votes cast in favor of the merger agreement on the part of Producers' shareholders were by shareholders unconnected with these defendants.

36. The allegations of paragraph 36 are denied.

37. The allegations of paragraph 37 are admitted with the further allegation that this paragraph as set forth by

the plaintiff contains misrepresentation of material facts in that it omits to state material facts necessary to be stated in order to make the statements made, in the light of the circumstances under which they were made, not misleading, including specifically the fact that the plaintiff fails to allege that the plaintiff laid before the Insurance Director of Arizona the very papers and matters on the basis of which it was simultaneously seeking an injunction in this Court.

38. The defendants admit that the two companies have been merged and otherwise deny the allegations of the paragraph.

WHEREFORE, the defendants pray that the plaintiff take nothing by its complaint, and that this action be dismissed and that judgment be given for the defendants herein, and for such other relief as may be just and proper.

LEWIS ROCA SCOVILLE BEAUCHAMP
& LINTON

By /s/ John P. Frank
JOHN P. FRANK

/s/ Jeremy E. Butler
JEREMY E. BUTLER
Attorneys for defendants
9th Floor, Title & Trust Building
Phoenix, Arizona

STATE OF ARIZONA)

) SS.

COUNTY OF MARICOPA)

ROBERT H. WALLACE, being first duly sworn on oath, deposes and says: That he is President of NATIONAL SECURITIES INC., a corporation, and Chairman of the Board of Directors of PRODUCERS LIFE INSURANCE COMPANY, a corporation, defendants herein, and that he makes this affidavit for and on behalf of said NATIONAL SECURITIES, INC. and PRODUCERS LIFE INSURANCE COMPANY, being duly authorized thereunto: That he has read the foregoing and knows the contents thereof, and that the matters and things therein set forth are true of affiant's own knowledge, except as to those matters therein stated on information and belief, and as to those matters he believes it to be true.

/s/ Robert H. Wallace
ROBERT H. WALLACE

Subscribed and sworn to before me this 1st day of September 1965.

/s/ [Illegible]
Notary Public

My commission expires 9-29-68

[Filed September 1, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

No. Civ-5466-Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., ET AL., DEFENDANTS

MOTION FOR JUDGEMENT ON THE PLEADINGS
OR IN THE ALTERNATIVE FOR
SUMMARY JUDGMENT

The defendants herein move for judgment on the pleadings based upon the supplemental complaint and answer thereto; or in the alternative, for summary judgment based upon the record as made to this point and the affidavit of Wallace attached hereto.

1. The grounds which we believe warrant judgment for the defendants are apparent on the pleadings without reference to any other document. As we argue, the Court is either without jurisdiction or the complaint fails to state a cause of action.

2. Nonetheless, understanding is considerably enriched by the previous filings on both sides and the Court may care to take them into account. We therefore put the matter alternatively as a motion for summary judgment based on the record. This motion is supported by the original brief of the defendants as filed at the first hearing, and by a supplemental memorandum filed herewith.

Dated this 1st day of September, 1965.

Respectfully submitted,

LEWIS ROCA SCOVILLE BEAUCHAMP
& LINTON

By /s/ John P. Frank
JOHN P. FRANK

/s/ Jeremy E. Butler
JEREMY E. BUTLER
Attorneys for Defendants

[Filed September 1, 1965]

STATE OF ARIZONA)
) SS.
COUNTY OF MARICOPA)

AFFIDAVIT OF ROBERT H. WALLACE

ROBERT H. WALLACE, being first duly sworn, upon his oath deposes and says that he is the President of National Producers Life Insurance Company and on May 4, 1964, was President of National Life and Casualty Insurance Company. In that capacity, he knows of his own knowledge that he did in fact present to the Arizona Director of Insurance, Mr. George Bushnell, the matter of how the stock of Producers should be carried on its books as an admitted asset, and the attached letter is a true and correct copy of the submission to Mr. Bushnell and of his approval of the figure used.

/s/ Robert H. Wallace
ROBERT H. WALLACE

Subscribed and sworn to before me this 1st day of September, 1965.

/s/ [Illegible]
Notary Public

My commission expires: September 29, 1968.

May 4, 1964

[2]

Mr. George A. Bushnell, Director
Department of Insurance
State of Arizona
Phoenix, Arizona

Dear Mr. Bushnell:

Request is hereby made on behalf of National Life and Casualty Insurance Company to invest \$1,114,964.87 of its funds in 125,979 shares of the common stock of Producers Life Insurance Company, an Arizona corporation, and to carry said investments on its books as an admitted asset of a value equal to the aforesaid cost.

If this may be done, please indicate your approval by signature at the foot of this letter.

Sincerely,

/s/ R. H. Wallace
R. H. WALLACE

Approved this 13th day of May, 1964

/s/ G. A. Bushnell
GEORGE A. BUSHNELL, Director

RHW:dhm

[Filed September 14, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. 5466 Phx

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNON, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS

MOTION OF SECURITIES AND EXCHANGE COMMISSION FOR PERMISSION TO AMEND COMPLAINT TO ADD PARTIES DEFENDANT

The Securities and Exchange Commission moves for an order permitting amendment of the Amended and Supplemental Complaint filed August 12, 1965 to add as defendants Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey and Producers Thrift & Loan Company, an Arizona corporation, by substituting revised pages 1, 2 and 3, in the form hereto attached, for the corresponding pages of the Amended and Supplemental Complaint on file.

[2] This motion is based on the files, records and proceedings herein, including the allegations contained in the Commission's Amended and Supplemental Complaint filed August 12, 1965 and in proposed amended pages 1, 2 and 3 hereto attached, and the attached affidavit of W. S. Tucker.

Respectfully submitted,

/s/ Arthur E. Pennekamp
ARTHUR E. PENNEKAMP
Regional Administrator

/s/ W. Stevens Tucker
W. STEVENS TUCKER
Assistant, Regional Administrator

/s/ F. E. Kennamer, Jr. WST
F. E. KENNAMER, JR.
Assistant General Counsel

/s/ James G. Newby
JAMES G. NEWBY
Attorney
Attorneys for
Securities and Exchange Commission

[Filed September 14, 1965]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. 5466 Phx

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNON, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRITT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS

MEMORANDUM ON PLAINTIFF'S MOTION TO
AMEND TO ADD PARTIES DEFENDANT

INTRODUCTORY

The Securities and Exchange Commission moves to amend its Amended and Supplemental Complaint filed August 12, 1965 to add as defendants Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey and Producers Thrift & Loan Company (additional defendants). The necessary changes would consist of:

- [2] (1) Adding their names to the caption on page 1.
- (2) Changing the title on page 1 to read "Second Amended and Supplemental Complaint for Injunction".
- (3) Adding their names as defendants in Part I, paragraph 1 at the top of page 2.
- (4) Adding a reference to Producers Thrift & Loan Company as an Arizona corporation at the end of paragraph 4 at the foot of page 2.
- (5) Deleting the words "in concert with the selling directors" from lines 21-23 on page 3.

These persons and their corporation were named as defendants in the original complaint and were dismissed by

order entered April 16, 1965 "without prejudice and without prejudice to plaintiffs to hereafter move to add the above named defendants as defendants herein."

These are the former directors, and their corporation, who sold stock and control of Producers Life to National Securities, Inc. about April 27, 1964 at a high premium-price and who realized added personal benefits of almost one million dollars in the form of non-compete agreements, in the transactions.

The original complaint, which was considered by the court at the hearing on April 16, 1965, did not demand any relief against these defendants other than the general remedy of injunction and the general demand for equitable relief.

Demand 1 of the Amended and Supplemental Complaint filed August 12, 1965 (the August 12 complaint) asks that the entire series of transactions and acts covering the period from March 15, 1964 to the filing of the Amended and Supplemental Complaint, [3] described in Part III thereof, be determined to constitute a device, scheme and artifice to defraud and acts, practices and a course of business in connection with the purchase and sale of securities, accomplished by the defendants in violation of Section 10 (b) of the Securities Exchange Act and Rule 17 CFR 240.10b-5. The complaint alleges that the additional defendants participated in these transactions and acts.

Demand 3 of the August 12 complaint asks for a restoration of the pre-April 27, 1964 status quo. If granted, this demand would require reversal of the transactions on and about April 27, 1964 by which the National group bought control of Producers Life from and with the assistance of the additional defendants. This relief would involve restoration of considerations received by the additional defendants in these transactions and other adjustments.

Demand 4 of the August 12 complaint asks for an accounting as to any damages to stockholders of Producers Life and unjust enrichment of defendants by reason of the acts of the presently named defendants and the additional defendants and an adjustment of the equities of the defendants and of stockholders of Producers Life on a fair and equitable basis. Inclusion of the additional defend-

ants as parties would enable the Court, in giving complete equitable relief, to shape its decree to charge them with any unjust enrichment they have received and with any damages they have caused and to adjust their interests as need be with those of the public stockholders of Producers Life.

Demand 5, the general demand for equitable relief, would enable the Court in its decree to make any other provisions or adjustments as to the additional defendants found to be necessary [4] or advisable in order to do complete equity.

THE APPLICABLE RULES

Rule 21 FRCP provides that "Parties may be dropped or added by order of the court on motion of any party or of its own initiative at any stage of the action and on such terms as are just."

Rule 20 FRCP provides that "All persons may be joined in one action as defendants if there is asserted against them jointly, severally or in the alternative, any right to relief in respect of or arising out of the same transaction, occurrence, or series of transactions or occurrences and if any question of law or fact common to all of them will arise in the action".

Rule 15 FRCP permits amendment "by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires."

Counsel for defendants were requested to stipulate that, subject to the approval of the Court, these amendments could be submitted but they refused.

Respectfully submitted,

ARTHUR E. PENNEKAMP
W. STEVENS TUCKER
F. E. KENNAMER, JR.
JAMES G. NEWBY

By /s/ W. Stevens Tucker
W. STEVENS TUCKER
Counsel for the Securities and
Exchange Commission.

[Letters to Shareholders of
Producers Life Insurance Company]

[EXHIBIT 32]

PRODUCERS LIFE INSURANCE COMPANY
AN OLD LINE LEGAL RESERVE COMPANY
2300 N. CENTRAL • PHOENIX, ARIZONA • AL 8-5711 • P.O. BOX 1870

December 4, 1964

MERGER NEEDS YOUR SUPPORT

Dear Stockholder:

Upon approval of the proposed merger, your company will have nearly two hundred million of insurance in force, approximately twice the premium income and assets of the next largest Arizona life insurance company, ten percent of the total insurance in force of all 146 Arizona life insurance companies, and will rank in the top 20% of all life insurance companies in the United States.

Profits, before taxes of \$460,000 for 1965 have been projected by management in the pro forma statement contained in my letter to you of November 27, 1964. This anticipated figure would result from the economies that can be effected by combining operations on all levels in the two companies.

The projected profit for 1965 alone is *twice* the total before tax profits for *the past five years*.

Of equal importance, the earning potential of future years should be further improved by projected new business volume of five million per month or sixty million for the year . . . which should result from the combining of *two strong, highly successful sales organizations* totalling approximately 250 licensed agents.

Your Board feels the size, strength, profit potential and expanding sales activities resulting from this merger will result in substantial investor interest in

your company. And, this can mean an increase in market price that would be important to all stockholders.

This merger needs your vote. Approval also means a 20% stock dividend which will increase your stock ownership and equalize the per share value of the two companies.

Delay or failure to send in your proxy can lose these benefits for you and for all stockholders. The proxy enclosed is a *special proxy* and is the *only proxy* which can be counted in favor of the merger. If you did not send in the special proxy approving the merger which was enclosed with my letter of November 27, please sign and return the enclosed proxy.

/s/ A. W. Saffert
A. W. SAFFERT, President

[SEAL]

National Securities, Inc. Affiliate

[EXHIBIT 37]

PRODUCERS LIFE INSURANCE COMPANY

AN OLD LINE LEGAL RESERVE COMPANY

2300 N. CENTRAL • PHOENIX, ARIZONA • AL 8-5711 • P.O. Box 1870

December 18, 1964

Dear Stockholder:

The time for decision is here!

In just a few days the meeting of the stockholders of Producers Life, called to approve the merger between Producers and National Life and Casualty (with Producers the surviving company), will be held.

Your support is essential if this vital forward step is to be taken. You have an opportunity to become a stock-

holder in a 200 million dollar insurance-in-force company that will rank in the upper 20% of all Life companies in the country. In 1965 alone management projects earnings of \$460,000.00 (more than twice the total earnings for the past five years combined). In addition, your company will have the assets, the facilities and the manpower to accelerate its rate of growth to further improve earnings in the years ahead.

If you have not already sent in your proxy *specifically approving* this merger, please sign the enclosed proxy—and mail it today.

If you still have some questions about the points that may have been raised by those who are opposing this important step forward for your company, the enclosed booklet should resolve any questions you may have. Please satisfy yourself that this merger is in your best interest—and then act promptly.

Remember too, upon approval of the merger, you will receive a 20% stock dividend—so that you will own *twelve* shares of stock in the new, larger, stronger and more profitable company for every *ten* shares you now own in Producers Life.

Time is short. Your support is vital. If you have not already sent in your proxy—do so today. This official proxy is the *only* proxy that can be voted *in favor* of the merger.

/s/ A. W. Saffert
A. W. SAFFERT, President

[SEAL]

National Securities, Inc. Affiliate

[EXHIBIT 39]

**PRODUCERS LIFE INSURANCE COMPANY
AN OLD LINE LEGAL RESERVE COMPANY****2300 N. CENTRAL • PHOENIX, ARIZONA • AL 8-5711 • P.O. Box 1870****January 1, 1965****STOCKHOLDERS GIVE MANAGEMENT
OVERWHELMING SUPPORT**

Stockholders voted two to one in favor of Producers Life management on every issue voted on at the December 31, 1964 special meeting.

Management's candidate to the Board of Directors, Joseph C. Shorrock, was elected by a vote of 536,787 to 222,820.

Management's proposal to stagger the terms of the members of the Board to provide for a continuity of management was approved by a vote of 542,384 to 217,329.

Management's proposal to move the date of the annual meeting to June was approved by a vote of 542,172 to 217,487.

Unfortunately, because of the snarl of last minute legal actions filed by the 'stockholder's committee', the merger was not voted on. This legal tangle was created by the 'committee' just two days before the meeting, as the 'committee' was rapidly losing stockholder support.

The meeting was recessed and will be re-convened as soon as practical for the vote on the merger. We are as anxious as you are to have the merger approved.

While we believe there is not one chance in a thousand that any of these desperation legal maneuvers by the 'committee' can succeed, we did not wish to hazard the problems of "un-merging" the two companies. Therefore, management believes it best to have the short delay.

[2] The continuing disruptive efforts of the 'committee', has had the effect of denying you many of the immediate benefits of the merger. The committee knows this. The 'committee's' efforts to get \$25,000 of your company's money for their own personal use . . . and their incredible demands to liquidate or plunge your company into receivership . . . have revealed their true motives. They appear to be determined to destroy your company if they cannot control it.

Fortunately the end is now in sight. It is obvious that the committee, in its total disregard for the interests of stockholders, has come to the end of its confusing and disruptive career. Thousands of stockholders have withdrawn their support from the committee since September. And, the flood of revocations and proxies that we are receiving daily proves that 'committee' support is continuing to dwindle.

These men on the 'committee', although rejected overwhelmingly as the stockholders meeting, may continue their efforts. So you may hear from them again. They have already tried "liquidation" and "receivership" so they may now go to another "gimmick" to try for a few more votes. In fact, they may even pop up with a new name and a new "face" as they did when Olsen and Bush had a one-time fling at proxies. *Stockholders who entrusted them with proxies, just threw away their votes.* Olsen and Bush did not even have enough regard for the trust placed in them to even bother to vote the proxies they received!

[3] The best thing to do now, is simply ignore the 'committee', or any other group that may be a front for raiders. If the last proxy you sent in was just like the enclosed proxy, it is not necessary to send in another one. However, if you are not absolutely certain that the last proxy you have signed was for the merger, then please send in the enclosed proxy and it will be voted in favor of the merger.

National Life stockholders have voted in favor of the merger. Now the final decision is up to you. Our company will be the surviving company with nearly \$200 mil-

lion insurance in force and we will rank in the top 20% of life companies in the nation. The future for our stock price will be the brightest in the history of our company. We will have nearly 250 licensed agents, and will have the facilities, personnel and ability to expand nationally to broaden our sales base.

Projected before-tax profits for 1965 alone are \$460,000, which is more than twice the total before-tax profits for the last five years. That means greater value for all of our stock.

This is the greatest step in our history. Send in the enclosed proxy. And, don't forget that approval of the merger also means a 20% stock dividend for you.

/s/ A. W. Saffert

A. W. SAFFERT, President

[EXHIBIT 41]

PRODUCERS LIFE INSURANCE COMPANY**AN OLD LINE LEGAL RESERVE COMPANY**

2300 N. CENTRAL • PHOENIX, ARIZONA • AL 8-5711 • P.O. Box 1870

February 23, 1965

Dear Stockholder:

If you sent your proxy to the self-appointed 'stockholders committee' as a result of their last mailing, you have been tricked.

They took a legal memorandum from a Superior Court Judge, twisted it, quoted it out of context and added to it, a series of their own distortions and outright misrepresentations. Their action was so flagrant and so damaging to the image of the Court that the Judge sent a personal letter to the lawyers condemning the 'committee' mailing.

The enclosed pamphlet has been prepared to point out many of the outrageous statements contained in the 'committee' mailing. We realize that you are getting sick and tired of all this controversy—but if you have any doubts about the kind of people we are dealing with—we urge you to take a few moments to read it.

We dislike having to attack the motives of anyone. Yet, as your officers and directors we cannot stand by and let the lies and distortions of this splinter group of agitators tie up the activities of your company. We cannot permit this 'committee' hate campaign to deny you the many benefits of the proposed merger. We cannot let these malcontents and disgruntled ex-employees block the greatest opportunity for growth, earnings and development that has ever been available to your company.

We think it is time for some plain speaking.

[2] THE COMMITTEE . . .

The 'committee' has been overwhelmingly rejected by the great majority of stockholders, their actions have been condemned by the Court, they have used every devious propaganda stunt imaginable to achieve their personal ob-

jectives, and they have consistently made shameful proposals that would seriously damage or destroy your company.

They have no insurance facilities, no top management experience and no knowledge of current company operations. They have never, during this entire period, made a single constructive suggestion or proposal.

On the contrary . . .

They have attempted to have the Court place your company in receivership; they have solicited your proxies to attempt to liquidate your company; they have attempted to hire your salesmen for competitive companies; they have circulated vicious reports and rumors to attempt to destroy the morale of your employees. They have admitted under oath that they were well aware that their activities were damaging to your company.

They quite obviously have no concern whatsoever about the 150 loyal employees who have helped build your company, no regard for the 14,000 stockholders whose investment over the many long years has finally brought your company to the threshold of a truly promising future and no thought for the 35,000 policyholders who have placed the financial security of themselves and their families in the hands of your company.

While the total lack of principle evidenced by their continued destructive tactics has been recognized by the great majority of the stockholders—who have cast their vote for the merger . . . many are still confused or discouraged and have not cast their vote. This is a situation where failure to vote is just as detrimental as voting against the merger—since it requires a two-thirds affirmative vote to approve the merger.

[3]

THE MERGER

The real savings, the real profits and the real benefits to all stockholders can come only through the merger of Producers Life and National Life. Our projected profits from operations for 1965 of \$460,000 are possible only through

operational economies that can be effected as a result of the merger. This is twice the total profits for the past five years for Producers Life. Or, to put it another way, this is ten times the average annual profits of your company for that period. Greater profits mean greater earnings per share for the stock of all stockholders.

Your company will increase in size to nearly \$200 million insurance in force and will move into the top 20% of all life insurance companies in the United States in size. This means greater growth opportunities, greater stature in the industry, and a major improvement in the competitive position of your company. The merged company will be approximately twice as large as the next Arizona life company in assets and premium income, and have nearly 10% of the total life insurance in force of all Arizona companies.

The merger, because of its very size, profit potential and opportunities for dramatic growth, points to a strong market for your stock. Securities analysts and other stock market specialists are strongly recommending the merger because the merged company also will have these elements for impressive growth: Experienced leadership, greater financial strength, full-line computer facilities, complete ranges of policies and services, anticipated premium income of over \$7 million per year, nearly 250 licensed agents, nearly \$20 million in assets and the ability to expand into additional markets.

If you are not absolutely certain that your last vote was cast in favor of the merger, please sign the enclosed proxy—so that we can end this controversy and get on with the much more important job of building a great company.

We have the competent personnel and facilities—the opportunity is here—with your help we can build one of the truly outstanding life insurance companies of America.

/s/ A. W. Saffert
A. W. SAFFERT, President

[EXHIBIT 13]

ANNUAL STATEMENT FOR THE YEAR 1964 OF THE
PRODUCERS LIFE INSURANCE COMPANY

Except for items 34, 35, 41A, 42, 48A, 49, 50 and 51, the figures on this page do not include separate account items, if any.

Dollars Cents

SUMMARY OF OPERATIONS
(ACCRUAL BASIS)

1.	Premiums and annuity considerations (Exhibit 1, Part 1)	
1.1	Life	2,195,855.88
1.2	Accident and health	127,487.12
2.	Considerations for supplementary contracts with life contingencies	-0-
3.	Considerations for supplementary contracts without life contingencies and dividend accumulations	175,484.29
4.	Net investment income (Exhibit 2)	411,557.28
5.	Miscellaneous Income	6,721.34
6.	Contribution by National Securities, Inc.	81,087.76
7.	Total	<u>2,948,143.67</u>
DEDUCT:		
8.	Death benefits	328,443.07
9.	Matured endowments	530.00
10.	Annuity benefits	-0-
11.	Disability benefits	1,356.27
12.	Surrender benefits	137,257.35
12A.	Group conversions	-0-
13.	Benefits under accident and health policies	68,717.82
14.	Interest on policy or contract funds	28,203.36
15.	Payments on supplementary contracts with life contingencies	200.00
16.	Payments on supplementary contracts without life contingencies and of dividend accumulations	216,955.99
17.	Increase in aggregate reserve for policies and contracts with life contingencies	858,822.00
18.	Increase in reserves for supplementary contracts without life contingencies and for dividend accumulations	58,837.38
19.	Increase in reserve for A & H contracts	10,419.83
20.	Subtotal (Items 8 to 19)	<u>1,709,243.07</u>
21.	Commissions on premiums and annuity considerations	443,858.30
22.		
23.	General insurance expenses (Exhibit 5, Cols. 1 and 2, Line 13) ..	814,645.05
24.	Insurance taxes, licenses and fees, excluding federal income taxes (Exhibit 6, Cols. 1 and 2, Line 10)	52,790.00
25.	Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums	(89,659.92)
26.		
27.	Total (Items 20 to 26)	<u>2,980,876.50</u>
28.	Net gain from operations before dividends to policyholders and federal income taxes and excluding capital gains and losses (Item 7 minus Item 27)	<u>17,267.17</u>

[EXHIBIT 13 Continued]

29. Dividends to life policyholders (Exhibit 7)	86,983.17
30. Dividends on accident and health policies (Exhibit 7)	-0-
31. Increase in amount provisionally held for deferred dividend policies	-0-
32. Total (Items 29 to 31)	<u>86,983.17</u>
32A. Net gain from operations after dividends to policyholders and before federal income taxes, excluding capital gains and losses (Item 28 minus Item 32)	(69,716.00)
32B. Federal income taxes incurred (excluding tax on capital gains) ..	-0-
33. NET GAIN FROM OPERATIONS AFTER DIVIDENDS TO POLICYHOLDERS AND FEDERAL INCOME TAXES (excluding tax on capital gains) AND EXCLUDING CAPITAL GAINS AND LOSSES (Item 32A minus Item 32B)	<u>(69,716.00)</u>

SURPLUS ACCOUNT

Dollars Cents

Dollars Cents

34. Special surplus funds December 31, previous year	332,587.00	43. Dividends to stockholders	41,579.80
35. Unassigned surplus December 31, previous year	\$95,788.86	44. Allocation of costs of dissident stockholders activities	81,000.00
36.		44B.	
36A. Paid in surplus from sale of Company's		45. Net capital losses (Exhibit 4, Line 10.2)	
36B. Treasury stock	268,967.00	46. Increase in reserve on account of change in valuation basis	
37. Net gain (from Item 33)	(69,716.00)	47. Net loss from non-admitted and related items (Exhibit 14, Col. 3, Line 40)	
38. Net capital gains (Exhibit 4, Line 10.2)	400,039.74	48. Increase in mandatory securities valuation reserve	49,444.92
39. Surplus paid-in		48A. Decrease in surplus of Separate Account Business (see Separate Account Statement)	
40. Net gain from non-admitted and related items (Exhibit 14, Col. 3, Line 40)	77,421.82	49. Special surplus funds December 31, current year (Item 27, Page 3)	326,238.00
41. Decrease in mandatory securities valuation reserve		50. Unassigned surplus December 31, current year (Item 29, Page 3)	906,785.70
41A. Increase in surplus of Separate Account Business (see Separate Account Statement)		51. Total	<u>1,404,983.42</u>
42. Total	<u>1,404,983.42</u>		

[EXHIBIT 14]

ANNUAL STATEMENT FOR THE YEAR 1964 OF THE
NATIONAL LIFE & CASUALTY INSURANCE COMPANY

Except for items 24, 35, 41A, 42, 48A, 49, 50 and 51, the figures on this page do not include separate account items, if any. Dollars Cents

SUMMARY OF OPERATIONS
(ACCRUAL BASIS)

1. Premiums and annuity considerations (Exhibit 1, Part 1)	
1.1 Life	2,344,766.89
1.2 Accident and health	86,165.32
2. Considerations for supplementary contracts with life contingencies	-0-
3. Considerations for supplementary contracts without life contingencies and dividend accumulations	197,713.17
4. Net investment income (Exhibit 2)	210,991.90
5. Consideration for increase in cash value—Life Policies Owned	24,126.59
6. Miscellaneous Income	2,975.25
7. Total	<u>2,866,739.12</u>
DEDUCT:	
8. Death benefits	147,102.57
9. Matured endowments	3,000.00
10. Annuity benefits	26,422.28
11. Disability benefits	(368.19)
12. Surrender benefits	364,839.96
12A. Group conversions	-0-
13. Benefits under accident and health policies	42,922.58
14. Interest on policy or contract funds	4,153.54
15. Payments on supplementary contracts with life contingencies	28.88
16. Payments on supplementary contracts without life contingencies and of dividend accumulations	520,291.23
17. Increase in aggregate reserve for policies and contracts with life contingencies	589,542.00
18. Increase in reserves for supplementary contracts without life contingencies and for dividend accumulations	37,627.11
19.	
20. Subtotal (Items 8 to 19)	<u>1,735,561.96</u>
21. Commissions on premiums and annuity considerations	257,382.04
22.	
23. General insurance expenses (Exhibit 5, Cols. 1 and 2, Line 13) ..	794,607.56
24. Insurance taxes, licenses and fees, excluding federal income taxes (Exhibit 6, Cols. 1 and 2, Line 10)	44,235.21
25. Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums	(29,886.87)
26.	
27. Total (Items 20 to 26)	<u>2,801,899.90</u>
28. Net gain from operations before dividends to policyholders and federal income taxes and excluding capital gains and losses (Item 7 minus Item 27)	<u>64,839.22</u>

[EXHIBIT 14 Continued]

29. Dividends to life policyholders (Exhibit 7)	100,496.10
30. Dividends on accident and health policies (Exhibit 7)	-0-
31. Increase in amount provisionally held for deferred dividend policies	-0-
32. Total (Items 29 to 31)	<u>100,496.10</u>
32A. Net gain from operations after dividends to policyholders and before federal income taxes, excluded capital gains and losses (Item 28 minus Item 32)	(35,656.88)
32B. Federal income taxes incurred (excluding tax on capital gains)	-0-
33. NET GAIN FROM OPERATIONS AFTER DIVIDENDS TO POLICYHOLDERS AND FEDERAL INCOME TAXES (excluding tax on capital gains) AND EXCLUDING CAPITAL GAINS AND LOSSES (Item 32A minus Item 32B)	<u>(35,656.88)</u>

SURPLUS ACCOUNT

Dollars Cents

Dollars Cents

34. Special surplus funds December 31, previous year		43. Dividends to stockholders	
35. Unassigned surplus December 31, previous year	860,446.90	44.	
36.		44A.	
36A.		44B.	
36B.		45. Net capital losses (Exhibit 4, Line 10.2)	477,076.69
37. Net gain (from Item 33)	(35,656.88)	46. Increase in reserve on account of change in valuation basis	
38. Net capital gains (Exhibit 4, Line 10.2)		47. Net loss from non-admitted and related items (Exhibit 14, Col. 3, Line 40),	174,430.32
39. Surplus paid in		48. Increase in mandatory securities valuation reserve	
40. Net gain from non-admitted and related items (Exhibit 14, Col. 3, Line 40)		48A. Decrease in surplus of Separate Account Business (see Separate Account Statement)	
41. Decrease in mandatory securities valuation reserve	148,969.56	49. Special surplus funds December 31, current year (Item 27, Page 3)	
41A. Increase in surplus of Separate Account Business (see Separate Account Statement)		50. Unassigned surplus December 31, current year (Item 29, Page 3)	<u>322,252.57</u>
42. Total	<u>973,759.58</u>	51. Total	<u>973,759.58</u>

**ANNUAL STATEMENT FOR THE YEAR 1964 OF THE
NATIONAL LIFE & CASUALTY INSURANCE COMPANY**

Form 1 Stocks to be granted in the following order and each group arranged alphabetically

SCHEDULE D—Part 2

Showing all STOCKS Owned December 31 of Current Year

THE FIGURES ON THIS PAGE
INCLUDE SEPARATE ACCOUNTS

Railroad (a) preferred (b) common
Public Utilities (a) preferred (b) common
Banks, Trust and Insurance Companies (a) preferred (b) common
Savings and Loan or Building and Loan Associations
Industrial and Miscellaneous (a) preferred (b) common.

Show sub-totals for each group and classification

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)		
DESCRIPTION Give complete and accurate description of all stocks owned and location of all street railway, bank, trust and miscellaneous companies	No. of Shares	Per Value Per Share	Book Value	Rate Per Share Used To Obtain Market Value	*Market Value	Actual Cost	Rate Declared in Each of Last Three Years		
							1962	1963	1964
STOCKS—PUBLIC UTILITY, COMMON									
Arizona Public Service Co.	500	2.50	9,496.61	39.00	19,500.00	10,324.34	.80	.80	.92
Sub-Total—Public Utility, Common			9,496.61		19,500.00	10,324.34			
STOCKS—BANKS, TRUST & INSURANCE COMPANIES, COMMON									
The Franklin Life Insurance Co.	2	2.00	85.50	53.00	106.60	85.50	.50	.25	.35
The Lincoln National Life Insurance Co.	5	5.00	360.00	172.00	860.00	360.00	1.00	1.00	1.20
Producers Life Insurance Co.	135,088	1.00	1,221,049.15	** 4.75	641,668.00	1,221,049.15	.05	.05	.05
Sub-Total—Banks, Trust & Insurance Companies, Common			1,221,494.65		642,634.00	1,221,494.65			
SAVINGS & LOAN—BUILDING & LOAN ASSOCIATIONS									
American Savings & Loan Association			10,000.00		10,000.00	10,000.00	4.50	4.50	4.625
First Federal Savings & Loan of Craig			10,000.00		10,000.00	10,000.00	4.50	4.50	4.50
First Federal Savings & Loan of Denver			10,000.00		10,000.00	10,000.00	4.50	4.50	4.375
Golden Savings & Loan Association			10,000.00		10,000.00	10,000.00	4.75	4.70	4.50
Great West Savings & Loan Association			10,000.00		10,000.00	10,000.00	4.75	4.70	4.45
Lamar Savings & Loan Association			10,000.00		10,000.00	10,000.00	4.50	4.50	4.50
Southwest Savings & Loan Association			10,000.00		10,000.00	10,000.00	4.50	4.75	4.75
Sub-Total—Savings & Loan—Building & Loan Associations			70,000.00		70,000.00	70,000.00			
STOCKS—INDUSTRIAL & MISCELLANEOUS, PREFERRED									
Owen-Illinois Glass Co., Cum. Pfd. \$100	100	100.00	10,030.99	(S) 99.00	9,998.57	10,030.99	4.00	4.00	4.00
Kaiser Cement & Gypsum Corp. (formerly Permonento)	100	50.00	5,380.75	(S) 57.00	5,462.35	5,380.75	5.00	5.00	5.00
The Swanson Company—Cum. Pfd. Series A	500	20.00	10,000.00	(S) 20.00	10,000.00	10,000.00	1.20	1.20	1.20
Sub-Total—Industrial & Miscellaneous, Preferred			25,411.74		25,460.92	25,411.74			
STOCKS—INDUSTRIAL & MISCELLANEOUS, COMMON									
Jaeger Machine Co.	1,500	5.00	19,628.40	12.00	18,000.00	19,628.40	.60	.60	.60
Lytton Financial Co.	416	1.00	9,600.00	14.00	5,824.00	9,600.00	.75	1.00	1.00
McCall Corporation	515	NP	18,812.50	24.00	12,360.00	18,812.50	.50	.50	.40
The Singer Company	200	10.00	18,250.00	80.00	16,000.00	18,250.00	3.10	2.125	2.00
Sub-Total—Industrial & Miscellaneous, Common			61,290.90		52,184.00	61,290.90			
Grand Total—All Stocks			1,857,698.90		809,778.92	1,888,521.63			

**Market value at 12-31-64.

Information being submitted to N.A.I.C.
for valuation.

**ANNUAL STATEMENT FOR THE YEAR 1964 OF THE
NATIONAL LIFE & CASUALTY INSURANCE COMPANY**

SCHEDULE D—Part 2

Showing all STOCKS Owned December 31 of Current Year

THE FIGURES ON THIS PAGE DO NOT INCLUDE SEPARATE ACCOUNT ITEMS, IF ANY.

and each group arranged
mon
(a) preferred (b) common
Associations
arranged (b) common

Show sub-totals for each group and classification

1 stocks ank,	(2)	(3)	(4)	(5)	(6)	(7)	(8)			Amount Received During Year	Increase, By Adjustment, In Book Value During Year	Decrease, By Adjustment, In Book Value During Year	Year Acquires	
	No. of Shares	Per Value Per Share	Book Value	Rate Per Share Used To Obtain Market Value	*Market Value	Actual Cost	Dividends							
							Rate Declared in Each of Last Three Years							
							1962	1963	1964					
COMMON	500	2.50	9,496.61	39.00	19,500.00	10,324.34	.80	.80	.92	140.00	None	None	1959,60,61,62	
			9,496.61		19,500.00	10,324.34				140.00	None	None		
	2	2.00	85.50	53.00	106.00	85.50	.50	.25	.35	6.69	None	None	1955	
	5	5.00	360.00	172.00	860.00	360.00	1.00	1.00	1.20	6.00	"	"	1955	
Common	135,088	1.00	1,221,049.15	** 4.75	641,668.00	1,221,049.15	.05	.05	.05	None	"	"	1964	
			1,221,494.65		642,634.00	1,221,494.65				12.69	None	None		
			10,000.00		10,000.00	10,000.00	4.50	4.625		725.83	None	None	1963	
			10,000.00		10,000.00	10,000.00	4.50	4.50	4.50	450.00	"	"	1954	
Associations			10,000.00		10,000.00	10,000.00	4.50	4.50	4.375	437.50	"	"	1954	
			10,000.00		10,000.00	10,000.00	4.75	4.70	4.50	450.00	"	"	1955	
			10,000.00		10,000.00	10,000.00	4.75	4.70	4.45	445.00	"	"	1954	
			10,000.00		10,000.00	10,000.00	4.50	4.50	4.50	450.00	"	"	1954	
			10,000.00		10,000.00	10,000.00	4.50	4.75	4.75	475.00	"	"	1960	
			70,000.00		70,000.00	70,000.00				3,433.33	None	None		
	ento)	100	100.00	10,030.99	(S) 99.00	9,998.57	10,030.99	4.00	4.00	4.00	400.00	None	None	1963
		100	50.00	5,380.75	(S) 57.00	5,462.35	5,380.75	5.00	5.00	5.00	250.00	"	"	1961
500		20.00	10,000.00	(S) 20.00	10,000.00	10,000.00	1.20	1.20	1.20	600.00	"	"	1959	
			25,411.74		25,460.92	25,411.74				1,250.00	None	None		
	1,500	5.00	19,628.40	12.00	18,000.00	19,628.40	.60	.60	.60	900.00	None	None	1963	
	416	1.00	9,600.00	14.00	5,824.00	9,600.00	.75	1.00	1.00	Stk. Div.	"	"	1964	
	515	NP	13,812.50	24.00	12,860.00	13,812.50	.50	.50	.40	50.00	"	"	1964	
	200	10.00	18,250.00	80.00	16,000.00	18,250.00	8.10	2.125	2.00	200.00	"	"	1964	
			61,290.90		52,184.00	61,290.90				1,150.00	None	None		
			1,387,693.90		809,778.92	1,388,521.63				5,986.02	None	None		

THE BOARD OF DIRECTORS OF THE NATIONAL ASSOCIATION OF REAL ESTATE BROKERS
 has decided to publish a list of the following firms and their respective
 members in the following order and each firm's arranged
 alphabetically in each group.
 (1) Firms which are members of the National Association of Real Estate Brokers
 (2) Firms which are members of the National Association of Real Estate Brokers
 (3) Firms which are members of the National Association of Real Estate Brokers
 (4) Firms which are members of the National Association of Real Estate Brokers
 (5) Firms which are members of the National Association of Real Estate Brokers
 (6) Firms which are members of the National Association of Real Estate Brokers
 (7) Firms which are members of the National Association of Real Estate Brokers
 (8) Firms which are members of the National Association of Real Estate Brokers
 (9) Firms which are members of the National Association of Real Estate Brokers
 (10) Firms which are members of the National Association of Real Estate Brokers

FIRM NAME	ADDRESS	CITY	STATE	MEMBERSHIP
The National Association of Real Estate Brokers	1234 Main Street	New York	New York	1000
The National Association of Real Estate Brokers	5678 Broadway	Los Angeles	California	2000
The National Association of Real Estate Brokers	9012 Market Street	Chicago	Illinois	1500
The National Association of Real Estate Brokers	3456 Elm Street	San Francisco	California	1800
The National Association of Real Estate Brokers	7890 First Avenue	Boston	Massachusetts	1200
The National Association of Real Estate Brokers	2345 Second Street	Philadelphia	Pennsylvania	1600
The National Association of Real Estate Brokers	6789 Third Street	Houston	Texas	1400
The National Association of Real Estate Brokers	1012 Fourth Street	Dallas	Texas	1300
The National Association of Real Estate Brokers	4567 Fifth Street	San Antonio	Texas	1100
The National Association of Real Estate Brokers	8901 Sixth Street	Austin	Texas	1000
The National Association of Real Estate Brokers	2134 Seventh Street	Fort Worth	Texas	900
The National Association of Real Estate Brokers	5478 Eighth Street	El Paso	Texas	800
The National Association of Real Estate Brokers	9012 Ninth Street	Phoenix	Arizona	700
The National Association of Real Estate Brokers	3456 Tenth Street	Tucson	Arizona	600
The National Association of Real Estate Brokers	7890 Eleventh Street	Albuquerque	New Mexico	500
The National Association of Real Estate Brokers	1012 Twelfth Street	Santa Fe	New Mexico	400
The National Association of Real Estate Brokers	4567 Thirteenth Street	Las Vegas	Nevada	300
The National Association of Real Estate Brokers	8901 Fourteenth Street	Reno	Nevada	200
The National Association of Real Estate Brokers	2134 Fifteenth Street	Salt Lake City	Utah	100
The National Association of Real Estate Brokers	5478 Sixteenth Street	Denver	Colorado	50
The National Association of Real Estate Brokers	9012 Seventeenth Street	Boulder	Colorado	20
The National Association of Real Estate Brokers	3456 Eighteenth Street	Fort Collins	Colorado	10
The National Association of Real Estate Brokers	7890 Nineteenth Street	Longmont	Colorado	5
The National Association of Real Estate Brokers	1012 Twentieth Street	Loveland	Colorado	2
The National Association of Real Estate Brokers	4567 Twenty-first Street	Windsor	Colorado	1
The National Association of Real Estate Brokers	8901 Twenty-second Street	Pueblo	Colorado	0
The National Association of Real Estate Brokers	2134 Twenty-third Street	Canon City	Colorado	0

[EXHIBIT 15]

[Form S-1 with Financials as of December 31, 1964
for National Securities, Inc.]

Preliminary—Pending Audit Completion

NATIONAL LIFE AND CASUALTY INSURANCE COMPANY

BALANCE SHEET

December 31, 1964

ADMITTED ASSETS (Note A)

Bonds (Note B)	\$1,093,992
Stocks other than affiliates (Note C)	168,111
Stocks of affiliates (Note D):	
Producers Life Insurance Company	641,868
Mortgage loans on real estate, first liens	2,469,984
Real estate (net of \$352,833 encumbrance) (Note E)	995,768
Policy loans	1,296,851
Cash	987,888
Data processing equipment (Note F)	108,936
Premiums due and deferred	495,834
Investment income due and accrued	89,163
Cash value of life policies owned	154,437
Refundable deposits	620
	<u>\$8,447,752</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES:

Aggregate reserve for all policies (Note G)	\$6,647,044
Policy and contract claims	22,967
Policyholders' funds:	
Premium deposit funds	\$ 126,603
Premiums received in advance	48,319
Policyholders' dividends due and unpaid	7,931
Provision for dividends payable in 1965	101,514
	<u>284,367</u>
Amounts held for others	37,291
Commissions payable	27,406
General expenses and taxes due and accrued	55,182
Unearned investment income	19,626
Mandatory security valuation reserve	10,204
Other liabilities	2,838

STOCKHOLDERS' EQUITY:

Capital stock issued and outstanding (Note H)	\$1,018,574
Unassigned surplus:	
Paid in	\$ 474,680
Earned (deficit)	(152,427)
	<u>322,253</u>
	<u>\$1,340,827</u>
	<u>\$8,447,752</u>

See notes to financial statements.

NATIONAL LIFE AND CASUALTY INSURANCE COMPANY

NOTES TO FINANCIAL STATEMENTS

December 31, 1964

A. ADMITTED ASSETS:

The accompanying financial statements have been prepared in conformity with accounting practices prescribed or permitted by the laws of Arizona and the regulations of its Department of Insurance, which practices are designed primarily to demonstrate ability to meet claims of policyholders. Pursuant to such practices, which differ (in some instances materially) from those generally accepted accounting principles followed by other types of business enterprises in their presentation of financial position and results of operations on the "going concern basis", (a) investment securities are carried in accordance with valuations established by the National Association of Insurance Commissioners, i.e., bonds are carried at cost, adjusted where appropriate for amortization of premium or discount, and stocks generally are carried at market values; (b) acquisition costs, such as commissions, costs of medical examinations and investigations, are charged to current operations as incurred; (c) certain assets designated as "non-admitted assets" are charged off against unassigned surplus; and (d) gains and losses, realized or unrealized, on investment securities are recorded directly to unassigned surplus.

"Admitted assets" are those assets permitted to be included in the determination of the financial condition of a life insurer. "Nonadmitted assets" are those not permitted so to be included.

No determination has been made of the effect of such differences on the accompanying financial statements.

The nonadmitted assets at December 31, 1964, amounted to \$547,731.

B. BONDS:

Bonds are carried at amortized cost which is the same as book value. United States Treasury bonds having a face value of \$224,500 and an amortized cost of \$223,761, are on deposit with the Arizona State Treasurer under the control of the Arizona Department of Insurance in conformity with the statutory requirement.

C. INVESTMENTS IN STOCKS OTHER THAN STOCKS OF AFFILIATES:

Stocks are carried at market value of \$168,111. Book value is \$166,645.

D. INVESTMENTS IN STOCK OF AFFILIATES:

During 1964 the Company acquired 135,088 shares of the Common capital stock of Producers Life Insurance Company, an Arizona legal reserve insurer. Of these shares 126,979 shares were acquired from National Securities, Inc. for \$1,175,085.75, the remaining 8,109 shares were purchased through various brokers for \$45,963.40 resulting in a total cost and book value of \$1,221,049.15. The excess of book value over market at December 31, 1964, of \$579,381.15 has been charged to unassigned surplus.

At a special meeting held December 31, 1964, the stockholders of the Company approved a Consolidation Agreement and Plan of Reorganization providing for the merger of the Company into Producers Life Insurance Company. The stockholders of Producers Life Insurance Company have not acted on the proposed merger.

E. REAL ESTATE:

Real estate is stated at book value which is cost, less accumulated depreciation, net of encumbrances and includes the following:

Property occupied by the Company	\$578,141
Property acquired in satisfaction of debt	80,536
Investment property (less mortgage payable of \$352,833)	268,253
Property owned, under contract of sale	68,839
	<u>\$995,769</u>

D. COMPANY STOCK HELD FOR EMPLOYEE PURCHASE PLAN:

The Company has established a plan for its employees whereby the Company purchases its own shares to sell to its employees at cost by means of payroll deductions. At December 31, 1964, \$29,528 was comprised of the following items:

shares purchased for	\$
Amounts withheld from payroll not yet allocated for purchases of specific shares	

\$29,528

E. DEFERRED EXPENSES:

On April 27, 1964, National Securities, Inc., purchased 14.4% of the outstanding capital stock of Producers Life Insurance Company of Phoenix, Arizona. This stock was subsequently sold at cost to National Life and Casualty Insurance Company, a majority owned subsidiary.

At the time of this purchase, National Securities assumed Producers liability for certain existing noncompetition agreements amounting to \$568,551, and entered into new noncompetition agreements amounting to \$979,000. Subsequent to the above transactions, the two companies entered into a five-year management contract effective July 1, 1964. See Note H for information regarding management contract.

The costs of the noncompetition agreements are being amortized over a five-year period as to the \$568,551, and over a ten-year period as to the \$979,000.

F. NOTES PAYABLE:

Stock of National Life and Casualty Insurance Company (675,954 shares) and stock of Southwest Savings and Loan Association (147,000 shares), both majority owned subsidiaries, has been pledged as collateral for 4½% notes in the amount of \$2,193,100. The Company is obligated on an unsecured 5½% note of \$75,000, due March 15,

1965. The cattle owned by the Company are subject to a chattel mortgage to secure a 5% note in the amount of \$56,635.

G. LONG TERM LIABILITIES:

Included in notes and mortgages payable, current and long term, are the following:

	Due Within One Year	Due After One Year	Total Liability
Real estate mortgages (Note B)	\$186,496	\$ 57,583	\$ 244,079
Unsecured 7% note due December 1, 1965, and December 1, 1966	30,000	20,000	50,000
Contracts not to compete (Note E)	193,838	1,292,371	1,486,209
	<u>\$410,334</u>	<u>\$1,369,954</u>	<u>\$1,780,288</u>

H. CONVERTIBLE DEBENTURES:

The 6% convertible debentures issued by National Securities (of which \$20,000,000 are authorized) mature July 1, 1981, with interest payable annually on July 1, and are convertible to Common stock at the book value of such stock as of the preceding December 31.

In connection with the merger of Arizona Public Finance Company with National Securities, Arizona Public issued 6% Series B convertible debentures to those persons holding 5% Series A debentures who did not elect to convert them to National Securities Common stock. The Series B debentures, which became an obligation of National Securities, mature June 27, 1983, and are convertible to Common stock of National Securities at the book value of such stock as of the preceding December 31.

As of December 31, 1964, there were outstanding \$620,150 of the original debentures and \$216,580 of the Series B debentures. The amount shown as outstanding for Series B debentures.

* * * *

[Entered February 7, 1966]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

Civil No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNON, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRITT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS

ORDER GRANTING MOTION FOR
PROTECTIVE ORDER

The cause having come before the Court upon defendant's motion for a protective order, and the motion having been submitted for decision upon the record and briefs on file; and it appearing to the Court that no showing has been made that any discovery plaintiff might secure by taking the deposition of defendant ARTHUR W. SAFFERT could aid in any way a discovery of facts which would perfect or tend to perfect a statement of a claim by plaintiff on which relief could be granted in this Court, under the law as it existed at the time of the events upon which plaintiff's asserted causes of action are based.

[2] IT IS ORDERED AND ADJUDGED that defendants' motion for a protective order to prevent the taking of a deposition of defendant ARTHUR W. SAFFERT is hereby GRANTED.

IT IS FURTHER ORDERED that the Clerk promptly serve copies of this order by United States mail upon the attorneys for the parties appearing in this cause.

February 7, 1966.

/s/ Wm. C. Mathes
Senior United States District Judge

* * * *

[Entered February 7, 1966]

UNITED STATES DISTRICT COURT
DISTRICT OF ARIZONA

Civil No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNON, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS.

ORDER DENYING PLAINTIFF'S MOTION TO
AMEND TO ADD PARTIES DEFENDANT

This cause having come before the Court upon plaintiff's motion to amend to add parties defendant, and the motion having been submitted for decision upon the record and briefs on file; and it appearing to the Court that, while there may be actionable claims against some of the proposed additional defendants for alleged breaches of

fiduciary duty under the laws of Arizona, the Securities and Exchange Commission has not asserted, and cannot assert under any Federal statute which the Commission is charged with the duty to enforce, a cause of action against these proposed defendants [see: *O'Neill v. Maytag*, 339 F.2d 764 (2nd Cir. 1964); *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2nd Cir. 1961)].

IT IS ORDERED that plaintiff's motion to add additional parties defendant is hereby DENIED.

IT IS FURTHER ORDERED that the Clerk of the Court promptly serve copies of this order by United States mail upon the parties appearing in this cause.

February 7, 1966.

/s/ Wm. C. Mathes
Senior United States District Judge

* * * *

UNITED STATES DISTRICT COURT,
DISTRICT OF ARIZONA

Civil No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS.

ORDER ON DEFENDANTS' MOTION FOR JUDGMENT ON THE PLEADINGS OR, IN THE ALTERNATIVE, FOR SUMMARY JUDGMENT

The cause having come before the Court upon defendants' motion for judgment on the pleadings or, in the alternative, for summary judgment; and the motion having been submitted for decision upon the record and briefs on file; and it appearing to the Court that:

[1] 1. A motion for judgment on the pleadings under Rule 12(c) of the Federal Rules of Civil Procedure raises the identical issue posed by a motion under Rule 12(b) (6), namely, whether the complaint states a claim upon which relief can be granted [see: *Friedman v. Washburn Co.*, 145 F.2d 715 (7th Cir. 1944); *Art Metal Construction Co. for Use of McCloskey & Co. v. Lehigh Structural Steel Co.*, 116 F.2d 57 (3rd Cir. 1940); 1A *Barron & Holtzoff, Federal Practice & Procedure* § 359, p. 398];

2. Plaintiff's Amended and Supplemental Complaint alleges violations of § 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 CFR 240.10b-5], arising from defendants' use of the mails in the solicitation of proxies for a proposed consolidation and reorganization of two stock insurance companies; the gist of the charge being that the solicitation material so mailed allegedly contained positive misrepresentations of material facts, and also failed to state material facts necessary to make the statements therein not misleading in light of the circumstances under which they were made;

3. The complaint prays for injunctive relief, and also demands—

That the Court enter a decree requiring and compelling the defendants and each of them to take all actions and measures which are necessary to rectify and correct the consequences of the wrongful and unlawful conduct of defendants as specified above and to restore Producers Life, National Life, their stockholders and the defendants to the status and economic condition which they occupied prior to April 27, 1964.

That the Court enter a decree requiring and compelling the defendants and each of them to make an accounting of the extent to which their actions and the actions of the selling directors in violation of Section 10(b) of the Act, 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5, and in derogation of the rights and interest of the stockholders of Producers Life, have resulted in damage to such stockholders, and the extent to which the defendants have been unjustly enriched at the expense of such stockholders; and that, by suitable decree of the Court, the respective equities of the defendants and the stockholders of Producers Life be arranged and adjusted on a fair and equitable basis, including, if warranted on the basis of the accounting made by the defendants, the subordination of the stock interests and other equities of National Securities in National Producers to the interests of those stockholders whose

equities have been diminished by reason of the unlawful and wrongful conduct of the defendants.

That the Commission may have all further relief that the Court may deem just, equitable, and necessary in the circumstances;

4. The acts complained of would fall within the prohibitions of the proxy-solicitation-anti-fraud provision of § 14 of the 1934 Act [15 U.S.C. § 78n], as implemented by Rule 14-9 [17 CFR 240.14a-9], but for the fact that the stock of the insurance companies involved has never been registered on any national securities exchange;

5. Not until sometime during 1966 will the coverage of § 14 be extended, by virtue of the act of August 20, 1964 [78 Stat. 569], to any corporation similarly situated to the insurance companies involved in this action; and then only if not exempted by new § 12(g)(2)(G) of the 1934 Act [15 U.S.C. § 78l(g)(2)(G)] which excludes "any security issued by an insurance company" provided the insurance company is subject to certain defined State regulation;

6. The legislative history of this new § 12(g)(2)(G) exemption includes, inter alia, the following:

This * * * amendment was adopted following testimony by a number of State insurance commissioners and representatives of stock insurance companies who unanimously opposed the subjecting of these insurance companies to the jurisdiction of the Securities and Exchange Commission in addition to the jurisdictions of the various State commissioners. Further, these witnesses opposed departure by the bill from the doctrine embodied in the McCarran Act that the regulation of insurance companies be left to the States. [House Report No. 1418, May 19, 1964; 1964 U.S. Code Cong., and Admin. News 8022];

7. Even if it be assumed that § 10(b) would otherwise be applicable to proxy solicitations [but see *Borak v. J. I. Case Co.*, unreported in the District Court, 317 F.2d 838, 846-847 (7th Cir. 1963), *aff'd* on other grounds, *sub nom. J. I. Case Co. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964)], and that a shareholder-approved cor-

porate consolidation and reorganization is a "purchase or sale" of securities within the meaning of § 10(b) and Rule 10b-5 [compare *H. L. Green Co. v. Childree*, 185 F. Supp. 95 (S.D.N.Y.1960), and *Voege v. American Sumatra Tobacco Corp.*, 241 F.Supp. 369 (D.Dela.1965), with *National Supply Co. v. Leland Stanford Jr. University*, 184 F.2d 689 (9th Cir. 1948), and *Sawyer v. Pioneer Mill Co.*, 190 F.Supp. 21 (D.Hawaii 1960), remanded 300 F.2d 200 (9th Cir. 1962), cert. den., 371 U.S. 814, 83 S.Ct. 24, 9 L.Ed.2d 55 (1962)], there still remains the question of whether the McCarran Act [59 Stat. 33, 15 U.S.C. §§ 1011-1015] does not preclude the application in this case of § 10(b), as implemented by Rule 10b-5;

8. 15 U.S.C. § 1012(b) states, in part:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * *;

9. The law of Arizona requires that any proposed merger of stock insurance companies be submitted to the Director of Insurance for his approval in accordance with the criteria set forth in A.R.S. § 20-731, which reads as follows:

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.

8. Would substantially reduce the security of service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

10. Arizona law further provides for an appeal to the State courts from a decision of the Director of Insurance made under the authority of A.R.S. § 20-731 [see A.R.S. §§ 20-161—20-166];

11. Moreover, the remedies which the Securities and Exchange Commission may seek in this Court are governed by § 21 (e) of the 1934 Act, which provides:

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter. [15 U.S.C. § 78u(a)]; and

[2] 12. The allegations of the Amended and Supplemental Complaint at bar, if taken to be true, are insufficient to warrant issuance of an injunction against future violations of § 10(b) and Rule 10b-5, since the requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supercede", laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012(b)]; and

[3] 13. Finally, plaintiff's demand for relief allegedly "necessary to rectify and correct the consequences of the

wrongful and unlawful conduct of defendants", includes a prayer for an accounting for unjust enrichment and other relief, which would be inappropriate (cf. Note, 79 Harv. L.Rev. 656 (1966); but see; III Loss, Securities Regulation 1824-1829 (2nd Ed. 1961); Cary, Book Review, 75 Harv.L.Rev. 857, 861 (1962)] and would, in all events, fall outside the scope of available relief provided in § 21(e) of the 1934 Act [15 U.S.C. § 78u(e)];

Accordingly, it is ordered that defendants' motion for judgment on the pleadings is hereby granted.

It is further ordered that defendants serve and lodge with the Clerk of the Court, within ten days from the date of this order, an appropriate form of judgment, which shall provide that plaintiff's action be dismissed without costs to any party, and that the judgment shall not constitute an adjudication upon the merits [Rule 41(b), Fed. Rules Civ. Proc.].

It is further ordered that the Clerk promptly serve copies of this order by United States mail upon the attorneys for the parties appearing in this cause.

(S) WM. C. MATHES,
Senior United States District Judge.

FEBRUARY 11, 1966.

[Entered March 14, 1966]

UNITED STATES DISTRICT COURT,
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. 5466-Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS.

JUDGMENT

This cause came on to be heard on Defendants' Motion for Judgment on the Pleadings or in the Alternative for Summary Judgment, and the Court being fully advised finds that the allegations in the pleadings fail to state a claim for which relief can be granted at the suit of the plaintiff in this action.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the Defendants' Motion for Judgment on the Pleadings be and the same is hereby granted, each party to bear its own costs.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Judgment shall not constitute an adjudication upon the merits.

DONE this 14th day of March, 1966.

/s/ Wm. C. Mathes,
Senior Judge

[Filed April 25, 1966]

UNITED STATES DISTRICT COURT,
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS.

NOTICE OF APPEAL

Notice is hereby given that the Securities and Exchange Commission, plaintiff herein, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the judgment signed on March 14, 1966, and entered in the Clerk's records on March 28, 1966, granting defendants' Motion for Judgment on the Pleadings.

/s/ Arthur E. Pennekamp
ARTHUR E. PENNEKAMP
Regional Administrator

/s/ W. Stevens Tucker
W. STEVENS TUCKER
Assistant Regional Administrator

/s/ F. E. Kennamer, Jr.
F. E. KENNAMER, JR.
Assistant General Counsel
San Francisco Regional Office
Securities and Exchange Commission
San Francisco, California 94102

Dated: April 25, 1966.

[Filed May 4, 1966]

UNITED STATES DISTRICT COURT,
DISTRICT OF ARIZONA
(Phoenix Division)

Civil Action No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT M. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BREEFERD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS.

DESIGNATION OF RECORD

Pursuant to Rule 75(a) of the Federal Rules of Civil Procedure, the Securities and Exchange Commission, plaintiff herein, hereby designates the entire record in this action as the record on appeal to the United States Court of Appeals for the Ninth Circuit.

/s/ Arthur E. Pennekamp
ARTHUR E. PENNEKAMP
Regional Administrator

/s/ W. Stevens Tucker
W. STEVENS TUCKER
Assistant Regional Administrator

/s/ F. E. Kennamer, Jr.
F. E. KENNAMER, JR.
Assistant General Counsel
San Francisco Regional Office
Securities and Exchange Commission
San Francisco, California 94102

Dated: May 4, 1966.

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 21,146 [November 14, 1967]

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

NATIONAL SECURITIES, INC., A CORPORATION; NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION; ROBERT H. WALLACE; ROBERT C. BOHANNAN, JR.; ARTHUR W. SAFFERT; TED WILKINS; JOHN S. BARRETT; JOSEPH B. SETTER; BREEFERD W. LARGE, JR.; RICHARD G. JOHNSON; ERNEST A. RICHARDS; WILLIAM A. REEDY; BONNIE B. BILBREY; PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION; AND PRODUCERS THRIFT & LOAN COMPANY, A CORPORATION; APPELLEES

On Appeal from the United States District Court
for the District of Arizona

Before JERTBERG and MERRILL, *Circuit Judges*, and
TAYLOR, *District Judge*.

JERTBERG, *Circuit Judge*: Before us is an appeal under 28 U.S.C. § 1291 by the plaintiff below and appellant in this court, Securities and Exchange Commission, from a final judgment of the United States District Court for the District of Arizona granting judgment on the pleadings for the defendants below, appellees here. The action was brought pursuant to Section 21e of the Securities and Exchange Act of 1934, 15 U.S.C. 78u(e), to enjoin violations of the anti-fraud provisions of that Act. Sec. 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 of that Act, 17 CFR 240.10b-5, and for other relief.

Appellant sought to undo the merger of two stock life insurance companies on the ground that the proxy solicitation material mailed to the stockholders of the two firms

contained positive misrepresentation of material facts; and also failed to state material facts necessary to make the statements therein not misleading in light of the circumstances under which they were made.

Appellee National Securities, Inc. is a Colorado corporation doing business in Arizona as a holding company owning a controlling interest in the stock of National Life & Casualty Insurance Company, an Arizona corporation. Appellees Wallace, Bohannon, Saffert, Wilkins, Barrett, Setter and Large are officers of the appellees National Securities, National Life, or another subsidiary of National Securities.

Appellee Producers Life Insurance Company is an Arizona corporation which conducts a life insurance business in Arizona and other western states.

As of April 27, 1964, Producers Life had approximately 14,000 stockholders with 880,000 shares of common stock issued and outstanding, including 50,203 treasury shares. Of that total, 66,320 shares were owned directly by a group consisting of Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey, and Producers Thrift & Loan Company, an Arizona corporation, whose stock was owned by Johnson, Richards, Reedy, Bilbrey and one other person, the first four being referred to in this litigation¹ as the "selling directors." The selling directors, together with J. Grant Iverson, Jess E. Hunter, and John J. Falconer, made up Producers Life's board of directors. In addition, the selling directors other than Bilbrey held voting proxies for about 565,000 shares.

The amended and supplemental complaint in substance alleges that since March 15, 1964, appellees and the selling directors have made use of means and instrumentalities in interstate commerce and the mails to advance a scheme by manipulative and deceptive devices in connection with the purchase and sale of stock in Producers Life and National Life to defraud Producers Life and its stockholders

¹ They, along with Producers Thrift & Loan Company, are not now parties to the action, the suit as to them having been dismissed without prejudice on April 16, 1965, R. 291, and appellant's motion to amend its amended complaint to include them having been denied on February 7, 1966. R. 794.

by making false and misleading statements, and that since that date appellees have effected various arrangements with the ultimate purpose of merging Producers Life with National Life in derogation of the rights of Producers Life's stockholders, and contrary to the fiduciary responsibilities of the selling directors and appellees Wallace, Saffert, Wilkins, Barrett, and Large.

The complaint sets forth in detail the various acts, transactions and occurrences which transpired, leading up to the consolidation agreement of November 27, 1964, between National Life and Producers Life. The agreement provided for the submission of the agreement to the stockholders of Producers Life and National Life.

Beginning in August, 1964, appellees National Securities, National Life, Bohannon, Wallace, Saffert, Wilkins, Barrett, Setter and Large conducted a proxy solicitation campaign by mailing communications to Producers Life's 14,000 stockholders throughout the United States. It is the alleged material misstatements and the alleged omission of material facts in these proxy solicitation communications of which appellant complains.

The complaint then alleges, in detail, numerous misstatements and omissions of material facts.

A special stockholders' meeting was held on April 19, or 26, 1965, at which the shareholders approved and confirmed the merger.

The complaint further alleges that following the stockholders meeting, the appellees sent false and misleading statements to the shareholders of Producers Life. It is further alleged that the consolidation agreement is void as an essential element of a fraudulent scheme and because it had never been validly approved by the requisite two-thirds majority of the stockholders.

It appears that the merger agreement was submitted to the Arizona Director of Insurance on May 7, 1965, and approved by him on July 9, 1965. It further appears that since that time the National Group has conducted the affairs of National Life and Producers Life as a single operation.

In the court below, appellant prayed for the following relief—

(1) that the alleged occurrences be adjudged fraudulent and in violation of § 10(b) and Rule 10b-5;

(2) that a preliminary and permanent injunction be entered against appellees to restrain them from further violations of § 10(b) and Rule 10b-5 in connection with any plan of reorganization, merger, etc., or with the solicitation of proxies to accomplish such plan;

(3) that appellees rectify the consequences of their wrongful conduct and restore Producers Life, National Life, their stockholders, and appellees to their status and economic condition as it existed prior to April 27, 1964;

(4) that appellees make an accounting for their unjust enrichment and the damage to the stockholders;

(5) that the equities of appellees and the stockholders of Producers Life be adjusted on a fair and equitable basis, including, if necessary, the subordination of National Securities' interests in National Producers; and

(6) any other relief which the court may deem just and equitable.

On September 1, 1965, appellees filed a motion for judgment on the pleadings or, in the alternative, for summary judgment. The district court granting the motion for summary judgment on the pleadings,² stated inter alia:

7. Even if it be assumed that § 10(b) would otherwise be applicable to proxy solicitations [citations omitted], and that a shareholder-approved corporate consolidation and reorganization is a 'purchase or sale' of securities within the meaning of § 10(b) and Rule 10b-5 [citations omitted], there still remains the question of whether the McCarran Act [59 Stat. 33, 15 U.S.C. §§ 1011-1015] does not preclude the application in this case of § 10(b), as implemented by Rule 10b-5;

8. 15 U.S.C. § 1012(b) states, in part:

² 252 F.S. 623 (D of Arizona) 1966.

"No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance * * *";

9. The law of Arizona requires that any proposed merger of stock insurance companies be submitted to the Director of Insurance for his approval in accordance with the criteria set forth in A.R.S. § 20-731, which reads as follows:

"A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

"B. No such merger or consolidation shall be effected unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.
3. Would substantially reduce the security of the service to be rendered to policyholders of the domestic insurer in this state or elsewhere."

10. Arizona law further provides for an appeal to the State courts from a decision of the Director of Insurance made under the authority of A.R.S. § 20-731 [see A.R.S. §§ 20-161-20-166];

11. Moreover, the remedies which the Securities and Exchange Commission may seek in this Court are governed by § 21 (e) of the 1934 Act, which provides:

"Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the

United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter." [15 U.S.C. § 78u(e)]; and

12. The allegations of the Amended and Supplemental Complaint at bar, if taken to be true, are insufficient to warrant issuance of an injunction against future violations of § 10(b) and Rule 10b-5, since the requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supercede", laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012(b)];

Appellant specifies that the district court erred:

1. [I]n granting defendants' [appellees'] motion for judgment on the pleadings on the ground that the McCarran Act precluded the application of the anti-fraud provisions of the Securities Exchange Act, Section 10(b), and Rule 10b-5 thereunder.

2. [I]n holding that it could not grant relief to "rectify and correct the consequences" of defendants' [appellees'] unlawful conduct and that it would be inappropriate and outside the scope of relief afforded by the Securities Exchange Act for the court to grant, as part of the requested remedy, an accounting for unjust enrichment and other relief.

3. [T]o the extent it may have suggested that the fraudulent statements made in connection with the consolidation of Producers Life and National Life into National Producers and the fraudulent omissions in the purchase of Producers Life treasury stock were

not "in connection with the purchase or sale" of securities within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

Appellees contend on this appeal that the suit must be dismissed for want of indispensable parties. The indispensable parties referred to are Johnson, Richards, Reedy and Bilbrey referred to earlier in this opinion as the "selling directors", and Producers Thrift & Loan Company, who are not now parties to the action. (See fn. 1).

It is clear that the district court did not reach the question whether the consolidation of Producers Life and National Life into National Producers involved purchases or sales of securities in connection with which the alleged fraud occurred.

In view of the conclusion which we have reached, we shall discuss only one of the issues of law raised by appellant. That issue is whether the allegations of the amended and supplemental complaint, which allegations must be presumed by us to be true, warrant the invalidation of the merger in light of the provisions of the McCarran Act.

The preamble to the McCarran Act sets forth its purpose:

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. 15 U.S.C. § 1011.

The Act further provides:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance. * * * 15 U.S.C. § 1012(b).

The Act then makes certain federal statutes (Sherman Act, Clayton Act, and Federal Trade Commission Act)

applicable to the business of insurance "to the extent that such business is not regulated by State law", and other Federal statutes (National Labor Relations Act, Fair Labor Standards Act of 1938, and Merchant Marine Act, 1920) fully applicable to the business of insurance. 15 U.S.C. §§ 1012(b), 1014.

The McCarran Act was passed following the decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944). In that case the Supreme Court held that interstate transactions in the business of insurance were interstate commerce and therefore subject to regulation by Congress under the commerce clause. This decision upset the previously long-held understanding that the business of insurance was not commerce and was subject only to state regulation. On this understanding was built a substantial structure of regulation by the states. "[T]he states took over exclusively the function of regulating the insurance business in its specific legislative manifestations. Congress legislated only in terms applicable to commerce generally, without particularized reference to insurance." *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 415 (1946).

Immediately after the *South-Eastern Underwriters* decision, Congress took action on previously-introduced bills to exempt the insurance business from federal anti-trust regulation. But the ultimate result was a bill which enunciated a considerably broader policy. The focus shifted from a narrow exemption from the Sherman and Clayton Acts to a general policy of exemption with specific exceptions to that policy. As was stated by the co-author of the bill, Senator Ferguson:

If there is on the books of the United States a legislative act which relates to the interstate commerce, if the act does not specifically relate to insurance, it would not apply at the present time. Having passed the bill now before the Senate, if Congress should tomorrow pass a law relating to interstate commerce, and should not specifically apply the law to the business of insurance, it would not be an implied repeal of this bill, and this bill would not be affected, because the Congress had not, under subdivision (b), said that

the new law specifically applied to insurance. 91 Cong. Rec. 481 (1945).

The following colloquy between Senator Ferguson and another major draftsman of the bill, Senator O'Mahoney, makes the same point:

Mr. FERGUSON. What we have in mind is that the insurance business, being interstate commerce, if we merely enact a law relating to interstate commerce, or if there is a law now on the statute books relating in some way to interstate commerce, it would not apply to insurance. We wanted to be sure that the Congress, in its wisdom, would act specifically with reference to insurance in enacting the law.

Mr. O'MAHONEY. In other words, no existing law and no future law should, by mere implication, be applied to the business of insurance.

Mr. FERGUSON. That is correct. 91 Cong. Rec. 1487 (1945).

It is clear that the Securities Exchange Act of 1934, appellant's statutory mainstay in this case, is grounded on Congress' power to regulate interstate commerce. See 15 U.S.C. § 78b. Cf. Preamble to Securities Act of 1933, 48 Stat. 74. There is no reference to the Securities Exchange Act in the debates on the McCarran Act. We are left then with a general intention to set the insurance business outside the scope of all existing and future legislation regulating interstate commerce, without any more direct evidence that Congress had in mind the Securities Exchange Act.* However, Congress was apparently seeking to define an exemption for insurance conterminous with its power to regulate interstate commerce. This is evident from sections 3 and 4 of the McCarran Act, 15 U.S.C. §§ 1013, 1014. There, Congress enumerated spe-

* There is evidence, however, that the role of the S.E.C. had been discussed in Congressional hearings held prior to the McCarran Act on the general subject of federal regulation of the insurance industry. See Joint Hearing before the Subcommittee of the Committee on the Judiciary, 78th Cong., 2d Sess., pt. 6, at 640 (1944); Sen. Doc. No. 35, 77th Cong., 1st Sess. at 41-42, 45, and 596 (1941).

cific statutes, grounded on its interstate commerce power, and the extent to which they should apply. It is significant that Congress felt that such diverse acts as the National Labor Relations Act and the Federal Trade Commission Act would otherwise have fallen within the exemption.

Mr. O'MAHONEY. * * * In drafting [the McCarran Act] we sought to spell out each particular law which might apply to insurance. We referred specifically to the Federal Trade Commission Act, the Robinson-Patman Act, the National Labor Relations Act, and the Fair Labor Standards Act. In other words, a good faith attempt was made to specify every single law which had an application, or might have an application, to insurance. 91 Cong. Rec. 483 (1945).

An equally vital purpose of the McCarran Act was to preserve intact from any federal intrusion based on the commerce clause, existing and future State regulation of the insurance industry. The commerce clause was not to be used as a springboard for federal regulation in the absence of specific statutory reference to insurance. By enacting the McCarran Act, Congress "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it, subject only to the exceptions expressly provided for." *Prudential Insurance Co. v. Benjamin, supra*, at 431. The major proponent of the bill, Senator McCarran, himself made this same point: "In enacting this law, Congress held out an invitation to the States to deal affirmatively and effectively with those activities and practices of the insurance business which might otherwise be subject to federal regulation." McCarran, *Federal Control of Insurance*, 34 A.B.A.J. 539, 540 (1948). See also Donovan, *Regulation of Insurance under the McCarran Act*, 15 Law & Contemp. Prob. 473, 490 (1950).

The State of Arizona accepted the invitation of the McCarran Act.

Among the purposes of this article is the regulation of trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945, 59 Stat. 33, by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined. Ariz. Rev. Stat. § 20-441 (1956).

The prohibited practices are then set out in subsequent sections. See Ariz. Rev. Stat. §§ 20-442—20-456. The section of the Arizona Insurance Code relating to mergers states:

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.
3. Would substantially reduce the security and service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

C. If the director does not approve the plan or agreement he shall so notify the insurer in writing specifying his reasons therefor. Ariz. Rev. Stat. § 20-781 (1959).

* The 1967 amendment to this section, effective January 1, 1968, makes special provision for title insurers but otherwise leaves the section intact.

The State of Arizona has affirmatively asserted its power to regulate the merger of insurance companies. It has not merely deemed such mergers to be legal, nor perfunctorily incorporated by reference its corporate merger provisions, but has set out additional standards and empowered a state agent to enforce them. The fact that these standards are not identical to those in the federal securities laws is not sufficient to allow the engrafting of federal standards into the merger.

It is not required that the assertion of State regulatory authority over a particular phase or practice of the insurance business shall provide the most effective regulation possible or that it shall be equally strict as the applicable federal law in the same field. Congress has recognized the right of the States to apply their own public policy in the regulation of the business of insurance. The important thing is that the State, with respect to the particular field of insurance or sphere of insurance activity, or the particular practice in question, shall have asserted its authority and imposed its regulatory powers. McCarran, *Federal Control of Insurance*, *supra*, at 541-542.⁵

Some light is shed on this problem by the enactment of the Securities Acts Amendments of 1964, 78 Stat. 565 (1964), effective in 1966, insofar as their legislative history displays Congress' current understanding of the scope of the McCarran Act.⁶

⁵ See, to the same effect, communication to the Yale Law Journal from Senator McCarran, dated April 21, 1950, quoted in Note, 60 Yale L.J. 160 at 163, n.11 (1951).

⁶ The House Committee Report includes the following:

"This committee amendment [excluding insurance companies on certain conditions] was adopted following testimony by a number of State insurance commissioners and representatives of stock insurance companies who unanimously opposed the subjecting of these insurance companies to the jurisdiction of the Securities and Exchange Commission in addition to the jurisdiction of the various State commissioners. Further, these witnesses opposed departure by the bill from the doctrine embodied in the McCarran Act that regulation of insurance companies be left to the States. The basic

As stated by the district court in its order granting judgment of dismissal:

4. The acts complained of would fall within the prohibitions of the proxy-solicitation-antifraud provision of § 14 of the 1934 Act [15 U.S.C. § 78(n)], as implemented by Rule 14a-9 [17 CFR 240.14a-9], but for the fact that the stock of the insurance companies involved has never been registered on any national securities exchange;

5. Not until sometime during 1966 will the coverage of § 14 be extended, by virtue of the act of August 20, 1964 [78 Stat. 569], to any corporation similarly situated to the insurance companies involved in this action; and then only if not exempted by new § 12(g) (2) (G) of the 1934 Act [15 U.S.C. § 78(1) (g) (2) (G)] which excludes "any security issued by an insurance company" provided the insurance company is subject to certain defined State regulation;

objection advanced by these witnesses went not to the requirements for the protection of investors for disclosure but only to the jurisdictional question.

"The thrust of the testimony by these representatives of the State insurance commissioners was that they be given an opportunity to demonstrate their ability effectively to protect the investors as well as the policyholders. The committee amendment gives these State commissioners this opportunity so to do." 1965 U.S. Code Cong. & Admin. News 3013, 3022.

"15 U.S.C. § 78(1) (g) (2) (G) provides that the provisions of the subject section shall not apply in respect of—

"(G) any security issued by an insurance company if all of the following conditions are met:

"(i) Such insurance company is required to and does file an annual statement with the Commissioner of Insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer or agency substantially conforms to that so prescribed.

"(iii) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authorizations in respect of securities issued by such company and such regu-

The Committee Report indicates the continued solicitude of the Congress for state regulation of the insurance business, including practices related to insurance stocks.

We are in accord with the views expressed by the district court that:

[T]he requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supersede", (sic) laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012 (b)].

The judgment appealed from is affirmed.

lation conforms to that prescribed by the National Association of Insurance Commissioners.

"(iii) After July 1, 1966, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 78p of this title."

The State of Arizona adopted legislation complying with such conditions. See Ariz. Rev. Stat. § 20-143.

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

No. 21146

**SECURITIES AND EXCHANGE COMMISSION, APPELLANT
NATIONAL SECURITIES INC., ET AL., APPELLEES**

**Appeal from the United States District Court for the
District of Arizona.**

**This cause came on to be heard on the Transcript of the
Record from the United States District Court for the Dis-
trict of Arizona and was duly submitted.**

**On consideration whereof, It is now here ordered and
adjudged by this Court, that the judgment of the said
District Court in this Cause be, and hereby is affirmed.**

Filed and entered Nov. 14, 1967.

SUPREME COURT OF THE UNITED STATES

No. 1201, October Term, 1967

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

NATIONAL SECURITIES, INC., ET AL.

ORDER ALLOWING CERTIORARI—Filed April 22, 1968

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

INDEX

Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and rule involved	2
Statement	2
Reasons for granting the writ	8
Conclusion	
Appendices:	
A. Opinion and Judgment Below	1a
B. District Court Opinion	13a
C. Relevant Statutes and Rule	25a

CITATIONS

Cases:	
11 <i>Dasho v. Susquehanna Corp.</i> , 380 F. 2d 262, certiorari denied <i>sub. nom. Birt v. Dasho</i> , 389 U.S. 977	10
<i>Federal Trade Commission v. Borden Co.</i> , 383 U.S. 637	16
<i>Federal Trade Commission v. National Casualty Co.</i> , 357 U.S. 560	13
<i>Federal Trade Commission v. Transfers Health Association</i> , 362 U.S. 293	10
<i>Haynes v. United States</i> , No. 236, this Term, decided January 29, 1968	18
<i>National Supply Co. v. Leland Stanford Junior University</i> , 134 F. 2d 689, certiorari denied, 320 U.S. 773	10
<i>Prudential Insurance Co. v. Benjamin</i> , 328 U.S. 408	10

Cases—Continued

	Page
<i>Securities and Exchange Commission v. American Founders Life Insurance Company of Denver, Colorado</i> (Civ. Action No. 6021, D. Colo., order dated May 7, 1958).....	12
<i>Securities and Exchange Commission v. United Benefit Life Insurance Co.</i> , 387 U.S. 202...	15
<i>Securities and Exchange Commission v. Variable Annuity Life Insurance Co., et al.</i> , 359 U.S. 65.....	9, 14
<i>Tcherepnin v. Knight</i> , 389 U.S. 332.....	9
<i>United States v. Meade</i> , 179 Supp. 868.....	12
<i>United States v. South-Eastern Underwriters Assn.</i> , 322 U.S. 533.....	10, 11, 12, 13
<i>United States v. Sylvanus</i> , 192 F. 2d 96, certiorari denied, 342 U.S. 943.....	15
<i>Vine v. Beneficial Finance Company</i> , 374 F. 2d 627, certiorari denied, 389 U.S. 970....	10
<i>Wilburn Boat Co. v. Fireman's Fund Insurance Co.</i> , 348 U.S. 310.....	11
Statutes and rule:	
McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. 1011-1015:	
Section 2(b), 15 U.S.C. 1012(b).....	2, 3, 8, 11
Section 4, 15 U.S.C. 1014.....	7, 16
Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77a, et seq:	
Section 3(a)(8), 15 U.S.C. 77c(a)(8).....	17
Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. 78a et seq:	
Section 3(a)(10), 15 U.S.C. 78c(a)(10)...	9
Section 10(b), 15 U.S.C. 78j(b).....	2, 3
Section 21(e) 15 U.S.C. 78u(e).....	7
Securities Acts Amendments of 1934, 78 Stat. 565.....	13, 17

Statutes and rule—Continued

Rule 10b-5, 17 C.F.R. 240.10b-5..... Page 2, 3

Miscellaneous:

Bests' Life Insurance Reports (62d ed. 1967)..... 9

Fifth Annual Report of the Securities and
Exchange Commission, Fiscal Year Ended
June 30, 1939..... 12

Hearings Before a Subcommittee of the House
Committee on Interstate and Foreign Com-
merce on H.R. 6789, H.R. 6793, S. 1642,
88th Cong., 1st Sess..... 12

H. Rep. No. 1418, 88th Cong., 2d Sess. (1964)..... 14

Report of Special Study of Securities Markets
of the Securities and Exchange Commis-
sion, H. Doc. No. 95, 88th Cong., 1st Sess.,
Pt. 3, Chap. IX (1963)..... 14

S. Rep. No. 379, 88th Cong., 1st Sess., (1963)..... 17

Seventh Annual Report of the Securities and
Exchange Commission, Fiscal Year Ended
June 30, 1941..... 12

Sixteenth Annual Report of the Securities and
Exchange Commission, Fiscal Year Ended
June 30, 1950..... 12

Twenty-Fourth Annual Report of the Securi-
ties and Exchange Commission, Fiscal Year
Ended June 30, 1958..... 12

Twenty-Fifth Annual Report of the Securities
and Exchange Commission, Fiscal Year
Ended June 30, 1959..... 12

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Rule 10b-5, 17 C.F.R. 240.10b-5

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Exchange Commission, Fiscal Year Ended
1970 Annual Report of the Securities and

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• Annual Report of the Secretary of the Board of Education, 1887-1888

Twenty-Fifth Annual Report of the Secretary

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In the Supreme Court of the United States

OCTOBER TERM, 1967

No. —

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

NATIONAL SECURITIES, INC., ET AL.

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE NINTH CIRCUIT**

The Solicitor General, on behalf of the Securities and Exchange Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in this case on November 14, 1967.

OPINIONS BELOW

The opinion of the court of appeals (Appendix A, *infra*, pp. 1a-16a) is not yet reported. The opinion of the district court (Appendix B, *infra*, pp. 18a-24a) is reported at 252 F. Supp. 623.

JURISDICTION

The judgment of the court of appeals was entered on November 14, 1967 (Appendix A, *infra*, pp. 16a-17a). On February 10, 1968, Mr. Justice Douglas extended the time for filing a petition for a writ of

certiorari to and including March 4, 1968. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Whether the McCarran-Ferguson Act, Section 2(b) of which provides that no Act of Congress shall "invalidate, impair or supercede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to" that business, precludes the application of the anti-fraud provisions of the Securities Exchange Act of 1934 to false and misleading statements made in soliciting stockholder consents to a merger of insurance companies.

STATUTES AND RULE INVOLVED

The relevant provisions of the McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. 1011-1015, Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, are set forth in Appendix C, *infra*, pp. 25a-27a).

STATEMENT

The Securities and Exchange Commission instituted this action in March 1965 in the district court to enjoin respondents National Securities, Inc. ("National Securities"), its subsidiary National Life and Casualty Insurance Company ("National Life"), and certain officers and employees of one or both of those companies, from violating the anti-fraud provisions of the Securities Exchange Act of 1934 (Section 10

(b) of that Act and the Commission's Rule 10b-5 thereunder) (R. 1-14).¹ The district court dismissed the suit on the pleadings (R. 804), and the court of appeals affirmed (App. A, *infra*, pp. 1a-16a), on the ground that the action was barred by the McCarran-Ferguson Act, Section 2(b) of which says (App. C, *infra*, p. 25a):

"No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance."

1. The Commission's complaint made the following allegations—which the court of appeals stated "must be presumed by us to be true" (App. A, *infra*, p. 8a):

National Securities is a holding company which owned two-thirds of the 1,018,574 outstanding shares of National Life, an insurance company incorporated in Arizona. Producers Life Insurance Company, Inc. ("Producers Life"), another insurance company incorporated in that State, had 881,976 outstanding shares of common stock, held by approximately 14,000 stockholders in many States. The defendants formed

¹ Section 10(b) makes it unlawful to use, in connection with the purchase or sale of any security in interstate commerce or through the mails, "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules. Rule 10b-5 makes it unlawful, in connection with such purchase or sale, "to employ any device, scheme, or artifice to defraud," to make "any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made * * * not misleading," or to engage "in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." App. C, *infra*, pp. 26a-27a.

an illegal scheme, in violation of the anti-fraud provisions of the Act, by which (a) National Securities would acquire control of Producers Life, (b) National Life and Producers Life would be consolidated, and (c) the consolidated company would pay a large part of National Securities' cost of acquiring control of Producers Life (R. 425-428).

As a step in obtaining control of Producers Life, National Securities purchased the stock of that company held by four of Producers Life's directors, and agreed to pay them large sums in return for their agreement not to compete with Producers Life or any successor company. At the same time National Securities purchased from Producers Life more than 50,000 shares of its treasury stock, and assumed its liabilities of more than \$600,000 stemming from prior agreements Producers Life had obtained from other persons not to compete with it (R. 428).^{*} National Securities did not disclose to Producers Life or its stockholders that it intended to impose these liabilities upon the corporation that would result from the planned consolidation of Producers Life and National Life (R. 433-434).

^{*} National Securities purchased 50,203 shares of treasury stock for \$2.30 per share, and also assumed liabilities payable over approximately eight years of \$527,891. National Securities' simultaneous purchase of 27,416 shares of Producers Life from four of the latter's directors was at \$20.72 per share, and its purchase from a company controlled by the same directors of 28,994 shares of Producers Life was at \$9.50 per share. In addition, the four directors were to be paid \$979,000 over the next 10-year period for their agreements not to compete (R. 428-429).

After obtaining control of Producers Life, National Securities caused the latter to mail to its stockholders material soliciting them to approve the proposed consolidation with National Life. This material was false and misleading because, among other things:

a. It did not disclose that the consolidated company would assume National Securities' liability of more than \$1,400,000 on the agreements not to compete.

b. It repeatedly predicted that the consolidated company would have net earnings of more than \$400,000 annually, but did not disclose that Producers Life and National Life had losses in the prior year (1964) of approximately \$70,000 and \$35,000, respectively.

c. It set forth in the pro-forma balance sheet for the consolidated company an asset shown as "Treasury Stock \$1,174,556" that was "illusory."

d. It did not disclose that in its 1964 Annual Report to the Arizona Insurance Commission, National Life had written down on its books the value of its stockholdings in Producers Life from \$1,164,000 to \$641,658 (R. 433-437).

2. Upon the filing of the Commission's action, the district court entered a preliminary restraining order which barred the defendants from violating the anti-fraud provisions of the Act but which did not prevent them from submitting the consolidation plan to the stockholders for approval (R. 437-438). The stockholders accepted the plan, the Arizona Insurance Commissioner approved it and the defendants effected the consolidation (R. 437-439). The Commission then filed an amended and supplemental complaint (R.

440-442) in which it requested broader relief than it originally had sought.

In granting the defendants' motion for judgment on the pleadings, the District Court held: (1) that the McCarran-Ferguson Act precluded the application of the anti-fraud provisions of the Securities Exchange Act of 1934 to the "requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance"; and (2) that the Commission's request for "an accounting for unjust enrichment and other relief" * * * would be inappropriate * * * and would, in all events, fall out-

* In addition to the injunction previously sought, the Commission requested that the defendants be required "to take all actions and measures which are necessary to rectify and correct the consequences of the[ir] wrongful and unlawful conduct * * * and to restore Producers Life, National Life, their stockholders and the defendants to the status and economic condition which they occupied prior to April 27, 1964 [the date of the alleged agreement between National Securities, Producers Life and the four selling directors thereof]"; that the defendants "make an accounting of the extent to which their [illegal] actions and the [illegal] actions of the selling directors * * * have resulted in damage to such stockholders, and the extent to which the defendants have been unjustly enriched at the expense of such stockholders"; and that "by suitable decree of the Court, the respective equities of the defendants and the stockholders of Producers Life be arranged and adjusted on a fair and equitable basis, including, if warranted on the basis of the accountings made by the defendants, the subordination of the stock interests and other equities of National Securities in National Producers [the consolidated company] to the interests of those stockholders whose equities have been diminished by reason of the unlawful and wrongful conduct of the defendants" (R. 440-442).

The Commission then filed an amended and supplemented complaint (R. 440-442).

side the scope of available relief provided in § 21(a) of the 1934 Act" (App. B, *infra*, pp. 23a-24a).

The court of appeals affirmed on the ground that the McCarran-Ferguson Act barred the action, and did not pass upon the propriety of the relief that the Commission sought. The court stated that in the McCarran-Ferguson Act Congress "define[d] an exemption for insurance continuous with its power to regulate interstate commerce"; that the legislative history of that Act disclosed "a general intention to set the insurance business outside the scope of all existing and future legislation regulating interstate commerce, without any more direct evidence that Congress had in mind the Securities Exchange Act"; that the provision in Section 4 of the McCarran-Ferguson Act making it inapplicable to the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act, 1930, indicated that Congress believed that otherwise those statutes would not apply to the business of insurance; and that in the McCarran-Ferguson Act Congress wished "to preserve intact from any federal intrusion based on the commerce clause, existing and future State regulation of the insurance industry" (App. A, *infra*, pp. 11a-12a). The court concluded its opinion with the statement that it

"Section 21(e) authorizes the Commission to bring an action in the district court to "enjoin such acts or practices" that appear to the Commission to violate the Act or its rules thereunder, and provides that "upon a proper showing a permanent or temporary injunction or restraining order shall be granted" 15 U.S.C. 78u(e).

was "in accord with" the following "views expressed by the district court":

[T]he requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supercede" (sic) laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act. [App. A, *infra*, p. 16a.]

REASONS FOR GRANTING THE WRIT

The holding of the court of appeals is that the McCarran-Ferguson Act (App. C, *infra*, p. 25a) precludes the application of the anti-fraud provisions of the Securities Exchange Act of 1934 to false and misleading statements made in soliciting stockholder approval of mergers of insurance companies because such application of the Securities Exchange Act would "invalidate, impair, or supersede" the law enacted by the State of Arizona "for the purpose of regulating the business of insurance" within the meaning of Section 2(b) of the McCarran-Ferguson Act. This holding creates a serious gap in the comprehensive investor protections that Congress provided in the Securities Exchange Act and is, we submit, an erroneous construction of the McCarran-Ferguson Act.

Mergers and consolidations of insurance companies are frequent. The most recent edition of the standard reference work on life insurance lists 164 combina-

tions of life insurance companies alone during the two-year period ending December 31, 1966; the figures undoubtedly would be even higher if mergers of other types of insurance companies were included. A large number of these companies have public stockholders. The need to protect stockholders against such misrepresentations as were allegedly made in connection with the consolidation of National Life and Producers Life is no less compelling for investors in insurance companies than for investors in other businesses. The traditional thrust of State insurance regulation has been the protection of policy holders, not stockholders. Cf. *Securities and Exchange Commission v. Variable Annuity Life Insurance Co., et al.*, 359 U.S. 65, 78-79 (concurring opinion of Mr. Justice Brennan). Only the antifraud provisions of the federal securities laws can provide insurance company stockholders with the full measure of protection Congress intended investors to have.

1. In Section 3(a)(10) of the Securities Exchange Act of 1934, Congress adopted a broad definition of "security" in order "to protect investors through the requirement of full disclosure by issuers of securities" (*Tcherepnin v. Knight*, 389 U.S. 882, 886). Section 10(b) of that Act makes "unlawful to use any manipulative or deceptive device or contrivance 'in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered'" (emphasis added). In the face of this clear congressional intent to extend the

* Best's Life Insurance Reports, pp. 1596-1602, (62d ed. 1967).

antifraud provisions to all sales and purchases of securities—and for many years the Commission has held that an exchange of securities such as was involved in the consolidation of National Life and Producers Life constitutes a “sale” of securities under the antifraud provisions of the Securities Exchange Act of 1934 and the Securities Act of 1933—an exception to the general broad scope of this important public legislation should not be created by implication unless it is clearly required by some other federal statute. The McCarran-Ferguson Act does not manifest any congressional intent, either in its language, design or legislative history, to carve out any exception from the antifraud provisions of the Securities Exchange Act for securities of insurance companies that are being consolidated.

The “basic purpose” of the McCarran-Ferguson Act “was to allay doubts, thought to have been raised by this Court’s decision of the previous year in *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533, as to the continuing power of the States to tax and regulate the business of insurance” (*Federal Trade Commission v. Travelers Health Association*, 362 U.S. 293, 299; see, also, *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429). “Accord-

The courts of appeals for the Second and Seventh Circuits recently upheld the Commission’s position on this question. *Fine v. Beneficial Finance Company*, 274 F. 2d 627 (C.A. 2), certiorari denied, 380 U.S. 970; *Dasho v. Susquehanna Corp.*, 380 F. 2d 262 (C.A. 7), certiorari denied *sub nom. Bard v. Dasho*, 380 U.S. 977. Twenty-five years ago the Ninth Circuit held to the contrary, *National Supply Co. v. Leland Stanford Junior University*, 134 F. 2d 689, certiorari denied, 320 U.S. 773.

ingly, the Act contains a broad declaration of congressional policy that the continued regulation of insurance by the States is in the public interest, and that silence on the part of Congress should not be construed to impose any barrier to continued regulation of insurance by the States" (*Wilburn Boat Co. v. Firemen's Fund Insurance Co.*, 348 U.S. 310, 319). In addition, Section 2(b) of the Act provides that "[n]o act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating [or taxing or imposing a fee upon] the business of insurance, * * * unless such act specifically relates to the business of insurance"; it further provides that the Sherman, Clayton and Federal Trade Commission Acts "shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

Because Congress did not define "the business of insurance," the meaning of that phrase must be determined by reference to the basic purpose and design of the legislation and the problems with which Congress was concerned. In *South-Eastern Underwriters* this Court had held for the first time that interstate sales of insurance policies and business activities related thereto constitute interstate commerce subject to congressional regulation under the Commerce Clause. But prior to that decision it never had been thought that interstate transactions in securities of insurance companies were any more beyond the reach of congressional power than transactions in securities of other companies. The federal securities laws, enacted ten years prior to *South-Eastern Underwrit-*

ers, drew no such distinction, and these laws have been applied both before and after the McCarran-Ferguson Act to sales of securities of insurance companies. Nothing in the history or language of the McCarran-Ferguson Act indicates any congressional intent to re-examine this previously established federal regulatory jurisdiction over securities transactions. The Act was wholly a response to the *South-Eastern* decision.

The annual reports of the Commission refer to various civil and criminal cases involving the application of the antifraud provisions of the federal securities laws to transactions in insurance company securities. See, e.g., Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1939, p. 250, respecting transactions in stock of Swamice Life Insurance Company; Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941, p. 338, respecting transactions in stock of Texas Mutual Reserve Life Ins. Co.; Sixteenth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1950, p. 207, respecting transactions in stock of Co-op Insurance Co.; Twenty-Fourth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1958, p. 231, respecting transactions in stock of Great Fidelity Life Insurance Co.; Twenty-Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1959, p. 270, respecting transactions in stock of American Buyers Insurance Co. and Unity Insurance Co.

Prior to the decision below, in the only decided cases we have found in which the McCarran-Ferguson Act was cited as a defense to an alleged violation of the antifraud provisions of the federal securities acts in the sale of insurance companies' securities, the McCarran-Ferguson Act was held not applicable. *Securities and Exchange Commission v. American Founders Life Insurance Company of Denver, Colorado* (Civ. Action No. 6031, D. Colo., order dated May 7, 1958) and *United States v. Meade*, 179 F. Supp. 933 (S.D. Ind.).

See, also, *Hearings Before A Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 6789, H.R. 6793, S. 1642, 86th Cong., 1st Sess. 176 (1958)*.

In addressing itself to regulation of "the business of insurance" in that Act, therefore, Congress was referring to those activities of insurance companies which, under the constitutional interpretation prevailing prior to *South-Eastern*, were exclusively the subject of State regulation. These included such matters as rates, the content, form and issuance of policies, the operation of the business, the maintenance of proper reserves, the prevention of unfair practices in dealing with policyholders (cf. *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560), etc. It was only with respect to those matters—the "business of insurance"—that Congress intended to preclude the application of federal legislation because it was only in those areas that any threat of interference with settled State practices was posed by the *South-Eastern Underwriters* decision.

Traditional State regulation of insurance, however, did not generally extend to the policing of the practices by which the companies obtained stockholder approval of mergers. Since 1964, and in response to the amendments to the Securities Exchange Act in that year,* a number of State insurance commissioners have undertaken to regulate the solicitation of proxies and insider trading in connection with

* Prior to the amendments of 1964 most regulatory provisions of the Securities Exchange Act, including those relating to proxy solicitations, were applicable only to securities that were registered on a national securities exchange. The 1964 amendments, generally speaking, subjected to these provisions widely-held securities not traded on exchanges but provided an exception for securities of insurance companies that were subject to specified types of state regulation, including proxy regulation.

insurance company securities. But prior thereto this was not generally the practice.* In any event these changes in State regulatory policy neither enlarged the scope of the McCarran-Ferguson Act nor provided antifraud protections comparable to those contained in the Securities Exchange Act.

In sum, Congress did not intend the methods whereby insurance companies obtained the consent of their stockholders to mergers to constitute "the business of insurance" that was immunized generally from federal regulation.

This is the clear import of this Court's decisions in *Securities and Exchange Commission v. Variable An-*

* This was recognized in testimony before a Subcommittee of the House Committee on Interstate and Foreign Commerce in regard to the 1964 Securities Acts amendments:

The State insurance commissioners through their organization, the National Association of Insurance Commissioners, testified that they recognized some validity to the contention in the commission's special study report that their procedures were primarily directed to matters concerning the protection of policyholders and to the need for some improvement in these procedures insofar as they relate to the protection of investors in the stock of these companies. [H. Rep. No. 1418, 88th Cong., 2d Sess., 10 (1964).]

The Commission's Special Study of Securities Markets referred to above concluded:

The operations of insurance companies are not supervised by any Federal Agency, but are regulated by the States in varying degrees. The emphasis, however, is consistently upon the solvency of the company, the adequacy of its reserves and the legality of its investments, rather than upon disclosure. In other words, State regulation of insurance companies is directed to the protection of the holders of insurance policies, not investors in insurance company securities. [Report of Special Study of Securities Markets of the Securities and Exchange Commission, H. Doc. No. 95, 88th Cong., 1st Sess., Pt. 3, Chap. IX, p. 40 (1963).]

nunity Life Insurance Co., 359 U.S. 65, and *Securities and Exchange Commission v. United Benefit Life Insurance Co.*, 387 U.S. 202. In holding there that variable annuities were "securities" under the Securities Act of 1933 rather than exempt "policies of insurance," the Court deemed it immaterial that the State regulatory authorities treated the companies as insurance companies and the annuities as insurance policies. In both cases the question whether the McCarran-Ferguson Act barred the application of the federal securities acts to the variable annuity contracts was argued.¹⁰ In ruling that the variable annuities were "securities" subject to the federal statutes, the Court necessarily held that the McCarran-Ferguson Act did not bar the application of such statutes to the issuance of securities of insurance companies.¹¹

2. The courts below further erred in concluding that the application of the Securities Exchange Act

¹⁰ See brief for the petitioner, No. 290, 1958 Term, pp. 54-61; brief for respondent *Equity Annuity Life Insurance Company*, *ibid.*, pp. 38-43; brief for respondent *Variable Annuity Life Insurance Company of America*, *ibid.*, pp. 49-72. Brief for respondent, No. 428, 1966 Term, pp. 25, 42-43.

¹¹ See, also, *United States v. Sylvania*, 192 F. 2d 96 (C.A. 7), certiorari denied, 342 U.S. 943, where the court, in upholding a conviction for mail fraud committed in connection with the sale of accident and sickness insurance policies, rejected the argument that the indictment was barred by the McCarran-Ferguson Act. It stated (p. 100): "we believe that it can not properly be said that this indictment has to do with the regulation of [the] insurance business in Illinois. Rather it has to do with the question of whether defendants have used the mails in pursuance of a scheme so to manipulate their authorized regulated business in Illinois as to result in fraudulent deceptions of its prospective policy holders."

to the consolidation of National Life and Producers Life would "impair", "invalidate" or "supersede" "laws enacted by the State of Arizona 'for the purpose of regulating the business of insurance'" (App. A, *infra*, p. 16a). The Arizona insurance law does not deal with or attempt to prevent misrepresentations in securities transactions, and we know of no State policy or statute designed to immunize such activities from regulation under the federal securities laws. The Commission's suit in no way sought to alter or modify any of the requirements that State law imposes upon insurance companies; its objective was solely to prevent misrepresentations in securities transactions and to obtain effective relief for shareholders who had been injured thereby."

3. Moreover, the court of appeals' decision rests in part upon the view that in the McCarran-Ferguson Act Congress provided "an exception for insurance conterminous with its power to regulate interstate commerce" and that, except for the three statutes to which the McCarran-Ferguson Act is made inapplicable by Section 4 thereof, federal regulatory legislation does not apply to insurance unless it specifically so states (App. A, *infra*, p. 11a). To that extent the effect of the decision would not be limited to mergers,

"The district court held that the relief the Commission sought (see note 3, p. 8, *supra*) was not authorized by the statute and would be inappropriate (App. B, *infra*, pp. 22a-22c). The court of appeals did not decide the question. If this Court grants the petition and reverses on the McCarran-Ferguson Act issue, it should remand for the court of appeals to consider the relief question and the other issues tendered by the parties that it did not decide. Cf. *Federal Trade Commission v. Borden Co.*, 383 U.S. 637, 639.

but would generally apply to the antifraud provisions of both the Securities Exchange Act and the Securities Act of 1933. Indeed, this branch of the court's reasoning would even seem to preclude the application of the registration requirement in Section 5 of the latter act to the issuance of securities of insurance companies, since that Section, like the antifraud provisions of both statutes, does not specifically refer to insurance companies.

The decision of the court of appeals inevitably will have an unsettling effect upon the administration and enforcement of both of these important federal statutes, and is likely to lead to extensive litigation. Neither before nor after the enactment of the McCarran-Ferguson Act had there been any serious question as to the applicability of the federal securities laws to transactions in the securities of insurance companies.¹¹ Although the Securities Act of 1933 exempts from registration the issuance of insurance policies themselves (Section 3(a)(8), 15 U.S.C. 77c(a)(8)), the securities of insurance companies always have been registered before a public offering thereof has been made. Similarly, it never has been suggested that insurance companies whose stock is listed on a registered securities exchange are not subject to all the requirements of the Securities Exchange Act of 1934. Indeed, in its report on legislation enacted in 1964 (78 Stat. 565) that extended certain provisions of the Securities Exchange Act of 1934 to companies whose securities were traded only over-the-counter, the Senate Committee on Banking and Currency stated (S. Rep. No. 379, 88th Cong., 1st Sess.,

¹¹ See note 7, p. 12, *supra*.

p. 36 (1963)): "Stock insurance companies are presently subject to the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934." 34

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

ERWIN N. GRISWOLD,

Solicitor General.

DANIEL M. FRIEDMAN,

Assistant to the Solicitor General.

PHILIP A. LOOMIS, JR.,

General Counsel,

DAVID FERBER,

Solicitor,

EDWARD B. WAGNER,

Assistant General Counsel,

FRANK N. FLEISCHER,

Attorney,

Securities and Exchange Commission.

MARCH 1968.

"Although the views of the Congress that enacted the 1964 legislation "provide no controlling basis from which to infer the purposes of an earlier Congress" that passed the McCarran-Ferguson Act, such views nevertheless are "pertinent." See *Haynes v. United States*, No. 236, this Term, decided January 29, 1968, slip op., n. 4, p. 2.

APPENDIX A

United States Court of Appeals for the Ninth Circuit

No. 21,146 [November 14, 1967]

SECURITIES AND EXCHANGE COMMISSION, APPELLANT

v.

NATIONAL SECURITIES, INC., a CORPORATION; NATIONAL LIFE & CASUALTY INSURANCE COMPANY, a CORPORATION; ROBERT H. WALLACE; ROBERT C. BOHANNAN, JR.; ARTHUR W. SAFFERT; TED WILKINS; JOHN S. BARRETT; JOSEPH B. SETTER; BREEFERD W. LARGE, JR.; RICHARD G. JOHNSON; ERNEST A. RICHARDS; WILLIAM A. REEDY; BONNIE B. BILBREY; PRODUCERS LIFE INSURANCE COMPANY, a CORPORATION; AND PRODUCERS THRIFT & LOAN COMPANY, a CORPORATION; APPELLEES

On Appeal from the United States District Court for the District of Arizona

Before JERTBERG and MERRILL, Circuit Judges, and TAYLOR, District Judge.

JERTBERG, Circuit Judge: Before us is an appeal under 28 U.S.C. § 1291 by the plaintiff below and appellant in this court, Securities and Exchange Commission, from a final judgment of the United States District Court for the District of Arizona granting judgment on the pleadings for the defendants below, appellees here. The action was brought pursuant to

Section 21e of the Securities and Exchange Act of 1934, 15 U.S.C. 78u(e), to enjoin violations of the anti-fraud provisions of that Act. Sec. 10(b), 15 U.S.C. 78j(b), and Rule 10b-5 of that Act, 17 CFR 240.10b-5, and for other relief.

Appellant sought to undo the merger of two stock life insurance companies on the ground that the proxy solicitation material mailed to the stockholders of the two firms contained positive misrepresentation of material facts, and also failed to state material facts necessary to make the statements therein not misleading in light of the circumstances under which they were made.

Appellee National Securities, Inc. is a Colorado corporation doing business in Arizona as a holding company owning a controlling interest in the stock of National Life & Casualty Insurance Company, an Arizona corporation. Appellees Wallace, Bohannon, Saffert, Wilkins, Barrett, Setter and Large are officers of the appellees National Securities, National Life, or another subsidiary of National Securities.

Appellee Producers Life Insurance Company is an Arizona corporation which conducts a life insurance business in Arizona and other western states.

As of April 27, 1964, Producers Life had approximately 14,000 stockholders with 880,000 shares of common stock issued and outstanding, including 50,203 treasury shares. Of that total, 66,320 shares were owned directly by a group consisting of Richard G. Johnson, Ernest A. Richards, William A. Reedy, Bonnie B. Bilbrey, and Producers Thrift & Loan Company, an Arizona corporation, whose stock was owned by Johnson, Richards, Reedy, Bilbrey and one other person, the first four being referred to in

this litigation¹ as the "selling directors." The selling directors, together with J. Grant Iverson, Jess E. Hunter, and John J. Falconer, made up Producers Life's board of directors. In addition, the selling directors other than Bilbrey held voting proxies for about 565,000 shares.

The amended and supplemental complaint in substance alleges that since March 15, 1964, appellees and the selling directors have made use of means and instrumentalities in interstate commerce and the mails to advance a scheme by manipulative and deceptive devices in connection with the purchase and sale of stock in Producers Life and National Life to defraud Producers Life and its stockholders by making false and misleading statements, and that since that date appellees have effected various arrangements with the ultimate purpose of merging Producers Life with National Life in derogation of the rights of Producers Life's stockholders, and contrary to the fiduciary responsibilities of the selling directors and appellees Wallace, Saffert, Wilkins, Barrett, and Large.

The complaint sets forth in detail the various acts, transactions and occurrences which transpired, leading up to the consolidation agreement of November 27, 1964, between National Life and Producers Life. The agreement provided for the submission of the agreement to the stockholders of Producers Life and National Life.

Beginning in August, 1964, appellees National Securities, National Life, Bohannon, Wallace, Saffert,

¹ They, along with Producers Thrift & Loan Company, are not now parties to the action, the suit as to them having been dismissed without prejudice on April 16, 1965, R. 291, and appellant's motion to amend its amended complaint to include them having been denied on February 7, 1966, R. 794.

Wilkins, Barrett, Setter and Large conducted a proxy solicitation campaign by mailing communications to Producers Life's 14,000 stockholders throughout the United States. It is the alleged material misstatements and the alleged omission of material facts in these proxy solicitation communications of which appellant complains.

The complaint then alleges, in detail, numerous misstatements and omissions of material facts.

A special stockholders' meeting was held on April 19, or 26, 1965, at which the shareholders approved and confirmed the merger.

The complaint further alleges that following the stockholders meeting, the appellees sent false and misleading statements to the shareholders of Producers Life. It is further alleged that the consolidation agreement is void as an essential element of a fraudulent scheme and because it had never been validly approved by the requisite two-thirds majority of the stockholders.

It appears that the merger agreement was submitted to the Arizona Director of Insurance on May 7, 1965, and approved by him on July 9, 1965. It further appears that since that time the National Group has conducted the affairs of National Life and Producers Life as a single operation.

In the court below, appellant prayed for the following relief—

(1) that the alleged occurrences be adjudged fraudulent and in violation of § 10(b) and Rule 10b-5;

(2) that a preliminary and permanent injunction be entered against appellees to restrain them from further violations of § 10(b) and Rule 10b-5 in connection with any plan of reorganization, merger, etc., or with the solicitation of proxies to accomplish such plan;

(3) that appellees rectify the consequences of their wrongful conduct and restore Producers Life, National Life, their stockholders, and appellees to their status and economic condition as it existed prior to April 27, 1964;

(4) that appellees make an accounting for their unjust enrichment and the damage to the stockholders;

(5) that the equities of appellees and the stockholders of Producers Life be adjusted on a fair and equitable basis, including, if necessary, the subordination of National Securities' interests in National Producers; and

(6) any other relief which the court may deem just and equitable.

On September 1, 1965, appellees filed a motion for judgment on the pleadings or, in the alternative, for summary judgment. The district court granting the motion for summary judgment on the pleadings, stated inter alia:

7. Even if it be assumed that § 10(b) would otherwise be applicable to proxy solicitations [citations omitted], and that a shareholder-approved corporate consolidation and reorganization is a 'purchase or sale' of securities within the meaning of § 10(b) and Rule 10b-5 [citations omitted], there still remains the question of whether the McCarran Act [59 Stat. 33, 15 U.S.C. §§ 1011-1015] does not preclude the application in this case of § 10(b), as implemented by Rule 10b-5;

8. 15 U.S.C. § 1012(b) states, in part:

"No Act of Congress shall be construed to invalidate, impair, or supercede any law enacted by any State for the purpose of regulating the business of insurance. . . .";

9. The law of Arizona requires that any proposed merger of stock insurance companies be submitted to the Director of Insurance for

his approval in accordance with the criteria set forth in A.R.S. § 20-731, which reads as follows:

"A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

"B. No such merger or consolidation shall be effected unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.
3. Would substantially reduce the security of the service to be rendered to policyholders of the domestic insurer in this state or elsewhere."

10. Arizona law further provides for an appeal to the State courts from a decision of the Director of Insurance made under the authority of A.R.S. § 20-731 [see A.R.S. §§ 20-161-20-166];

11. Moreover, the remedies which the Securities and Exchange Commission may seek in this Court are governed by § 21(e) of the 1934 Act, which provides:

"Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction

of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter." [15 U.S.C. § 78u (e)]; and

12. The allegations of the Amended and Supplemental Complaint at bar, if taken to be true, are insufficient to warrant issuance of an injunction against future violations of § 10(b) and Rule 10b-5, since the requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supersede", laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012(b)];

Appellant specifies that the district court erred:

1. [I]n granting defendants' [appellees'] motion for judgment on the pleadings on the ground that the McCarran Act precluded the application of the antifraud provisions of the Securities Exchange Act, Section 10(b), and Rule 10b-5 thereunder.

2. [I]n holding that it could not grant relief to "rectify and correct the consequences" of defendants' [appellees'] unlawful conduct and that it would be inappropriate and outside the scope of relief afforded by the Securities Exchange Act for the court to grant, as part of the requested remedy, an accounting for unjust enrichment and other relief.

3. [T]o the extent it may have suggested that the fraudulent statements made in connection

with the consolidation of Producers Life and National Life into National Producers and the fraudulent omissions in the purchase of Producers Life treasury stock were not "in connection with the purchase or sale" of securities within the meaning of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

Appellees contend on this appeal that the suit must be dismissed for want of indispensable parties. The indispensable parties referred to are Johnson, Richards, Reedy and Bilbrey referred to earlier in this opinion as the "selling directors", and Producers Thrift & Loan Company, who are not now parties to the action. (See fn. 1.)

It is clear that the district court did not reach the question whether the consolidation of Producers Life and National Life into National Producers involved purchases or sales of securities in connection with which the alleged fraud occurred.

In view of the conclusion which we have reached, we shall discuss only one of the issues of law raised by appellant. That issue is whether the allegations of the amended and supplemental complaint, which allegations must be presumed by us to be true, warrant the invalidation of the merger in light of the provisions of the McCarran Act.

The preamble to the McCarran Act sets forth its purpose:

Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. 15 U.S.C. § 1011.

The Act further provides:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance. * * * 15 U.S.C. § 1012(b).

The Act then makes certain federal statutes (Sherman Act, Clayton Act, and Federal Trade Commission Act) applicable to the business of insurance "to the extent that such business is not regulated by State law", and other Federal statutes (National Labor Relations Act, Fair Labor Standards Act of 1938, and Merchant Marine Act, 1920) fully applicable to the business of insurance. 15 U.S.C. §§ 1012(b), 1014.

The McCarran Act was passed following the decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533 (1944). In that case the Supreme Court held that interstate transactions in the business of insurance were interstate commerce and therefore subject to regulation by Congress under the commerce clause. This decision upset the previously long-held understanding that the business of insurance was not commerce and was subject only to state regulation. On this understanding was built a substantial structure of regulation by the states. "[T]he states took over exclusively the function of regulating the insurance business in its specific legislative manifestations. Congress legislated only in terms applicable to commerce generally, without particularized reference to insurance." *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 415 (1946).

Immediately after the *South-Eastern Underwriters* decision, Congress took action on previously-introduced bills to exempt the insurance business from federal anti-trust regulation. But the ultimate result was

a bill which enunciated a considerably broader policy. The focus shifted from a narrow exemption from the Sherman and Clayton Acts to a general policy of exemption with specific exceptions to that policy. As was stated by the co-author of the bill, Senator Ferguson:

If there is on the books of the United States a legislative act which relates to the interstate commerce, if the act does not specifically relate to insurance, it would not apply at the present time. Having passed the bill now before the Senate, if Congress should tomorrow pass a law relating to interstate commerce, and should not specifically apply the law to the business of insurance, it would not be an implied repeal of this bill, and this bill would not be affected, because the Congress had not, under subdivision (b), said that the new law specifically applied to insurance. 91 Cong. Rec. 481 (1945).

The following colloquy between Senator Ferguson and another major draftsman of the bill, Senator O'Mahoney, makes the same point:

Mr. FERGUSON. What we have in mind is that the insurance business, being interstate commerce, if we merely enact a law relating to interstate commerce, or if there is a law now on the statute books relating in some way to interstate commerce, it would not apply to insurance. We wanted to be sure that the Congress, in its wisdom, would act specifically with reference to insurance in enacting the law.

Mr. O'MAHONEY. In other words, no existing law and no future law should, by mere implication, be applied to the business of insurance.

Mr. FERGUSON. That is correct. 91 Cong. Rec. 1487 (1945).

It is clear that the Securities Exchange Act of 1934, appellant's statutory mamstay in this case, is grounded on Congress' power to regulate interstate commerce. See 15 U.S.C. § 78b. Cf. Preamble to Securities Act of

1933, 48 Stat. 74. There is no reference to the Securities Exchange Act in the debates on the McCarran Act. We are left then with a general intention to set the insurance business outside the scope of all existing and future legislation regulating interstate commerce, without any more direct evidence that Congress had in mind the Securities Exchange Act.* However, Congress was apparently seeking to define an exemption for insurance coterminous with its power to regulate interstate commerce. This is evident from sections 3 and 4 of the McCarran Act, 15 U.S.C. §§ 1013, 1014. There, Congress enumerated specific statutes, grounded on its interstate commerce power, and the extent to which they should apply. It is significant that Congress felt that such diverse acts as the National Labor Relations Act and the Federal Trade Commission Act would otherwise have fallen within the exemption.

Mr. O'MAHONEY. * * * In drafting [the McCarran Act] we sought to spell out each particular law which might apply to insurance. We referred specifically to the Federal Trade Commission Act, the Robinson-Patman Act, the National Labor Relations Act, and the Fair Labor Standards Act. In other words, a good faith attempt was made to specify every single law which had an application, or might have an application, to insurance. 91 Cong. Rec. 483 (1945).

An equally vital purpose of the McCarran Act was to preserve intact from any federal intrusion based on

* There is evidence, however, that the role of the S.E.C. had been discussed in Congressional hearings held prior to the McCarran Act on the general subject of federal regulation of the insurance industry. See Joint Hearing before the Subcommittee of the Committee on the Judiciary, 78th Cong., 2d Sess., pt. 6, at 640 (1944); Sen. Doc. No. 35, 77th Cong., 1st Sess., at 41-42, 45, and 596 (1941).

the commerce clause, existing and future State regulation of the insurance industry. The commerce clause was not to be used as a springboard for federal regulation in the absence of specific statutory reference to insurance. By enacting the McCarran Act, Congress "clearly put the full weight of its power behind existing and future state legislation to sustain it from any attack under the commerce clause to whatever extent this may be done with the force of that power behind it, subject only to the exceptions expressly provided for." *Prudential Insurance Co. v. Benjamin*, *supra*, at 431. The major proponent of the bill, Senator McCarran, himself made this same point: "In enacting this law, Congress held out an invitation to the States to deal affirmatively and effectively with those activities and practices of the insurance business which might otherwise be subject of federal regulation." McCarran, *Federal Control of Insurance*, 34 A.B.A.J. 539, 540 (1948). See also Donovan, *Regulation of Insurance under the McCarran Act*, 15 Law & Contemp. Prob. 473, 490 (1950).

The State of Arizona accepted the invitation of the McCarran Act.

Among the purposes of this article is the regulation of trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945, 59 Stat. 33, by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined. Ariz. Rev. Stat. § 20-441 (1956).

The prohibited practices are then set out in subsequent sections. See Ariz. Rev. Stat. §§ 20-442—20-456.

The section of the Arizona Insurance Code relating to mergers states:

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.
3. Would substantially reduce the security and service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

C. If the director does not approve the plan or agreement he shall so notify the insurer in writing specifying his reasons therefor. Ariz. Rev. Stat. § 20-731 (1959).⁴

The State of Arizona has affirmatively asserted its power to regulate the merger of insurance companies. It has not merely deemed such mergers to be legal, nor perfunctorily incorporated by reference its corporate merger provisions, but has set out additional standards and empowered a state agent to enforce them. The fact that these standards are not identical to those in the federal securities laws is not sufficient to allow the engrafting of federal standards into the merger.

⁴The 1967 amendment to this section, effective January 1, 1968, makes special provision for title insurers but otherwise leaves the section intact.

It is not required that the assertion of State regulatory authority over a particular phase or practice of the insurance business shall provide the most effective regulation possible or that it shall be equally strict as the applicable federal law in the same field. Congress has recognized the right of the States to apply their own public policy in the regulation of the business of insurance. The important thing is that the State, with respect to the particular field of insurance or sphere of insurance activity, or the particular practice in question, shall have asserted its authority and imposed its regulatory powers. McCarran, *Federal Control of Insurance, supra*, at 541-542.*

Some light is shed on this problem by the enactment of the Securities Acts Amendments of 1964, 78 Stat. 565 (1964), effective in 1966, insofar as their legislative history displays Congress' current understanding of the scope of the McCarran Act.*

*See, to the same effect, communication to the Yale Law Journal from Senator McCarran, dated April 21, 1950, quoted in Note, 60 Yale L.J. 160 at 163, n.11 (1951).

*The House Committee Report includes the following:

"This committee amendment [excluding insurance companies on certain conditions] was adopted following testimony by a number of State insurance commissioners and representatives of stock insurance companies who unanimously opposed the subjecting of these insurance companies to the jurisdiction of the Securities and Exchange Commission in addition to the jurisdiction of the various State commissioners. Further, these witnesses opposed departure by the bill from the doctrine embodied in the McCarran Act that regulation of insurance companies be left to the States. The basic objection advanced by these witnesses went not to the requirements for the protection of investors for disclosure but only to the jurisdictional question.

"The thrust of the testimony by these representatives of the State insurance commissioners was that they be given an op-

As stated by the district court in its order granting judgment of dismissal:

4. The acts complained of would fall within the prohibitions of the proxy-solicitation-anti-fraud provision of § 14 of the 1934 Act [15 U.S.C. § 78(n)], as implemented by Rule 14a-9 [17 CFR 240.14a-9], but for the fact that the stock of the insurance companies involved has never been registered on any national securities exchange.

5. Not until sometime during 1966 will the coverage of § 14 be extended, by virtue of the act of August 20, 1964 [78 Stat. 569], to any corporation similarly situated to the insurance companies involved in this action; and then only if not exempted by new § 12(g)(2)(G) of the 1934 Act [15 U.S.C. § 78(l)(g)(2)(G)] which excludes "any security issued by an insurance company" provided the insurance company is subject to certain defined State regulation;

portunity to demonstrate their ability effectively to protect the investors as well as the policyholders. The committee amendment gives these State commissioners this opportunity so to do." 1965 U.S. Code Cong. & Admin. News 2013, 2022.

' 15 U.S.C. § 78(l)(g)(2)(G) provides that the provisions of the subject section shall not apply in respect of—

"(G) any security issued by an insurance company if all of the following conditions are met:

"(i) Such insurance company is required to and does file an annual statement with the Commissioner of Insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer or agency substantially conforms to that so prescribed.

"(iii) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authoriza-

The State of Arizona adopted legislation complying with such conditions. See Ariz. Rev. Stat. § 20-141.

The Committee Report indicates the continued solicitude of the Congress for state regulation of the insurance business, including practices related to insurance stocks.

We are in accord with the views expressed by the district court that:

[T]he requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supersede", (sic) laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012(b)].

The judgment appealed from is affirmed.

United States Court of Appeals for the Ninth Circuit

No. 21146

SECURITIES AND EXCHANGE COMMISSION, APPELLANT
NATIONAL SECURITIES INC., ET AL., APPELLEES

Appeal from the United States District Court for the District of Arizona.

This cause came on to be heard on the Transcript of conditions in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.

"(iii) After July 1, 1968, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 78p of this title."

The State of Arizona adopted legislation complying with such conditions. See Ariz. Rev. Stat. § 20-143.

the Record from the United States District Court for the District of Arizona and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered Nov. 14, 1967.

APPENDIX B

United States District Court, District of Arizona

Civil No. 5466 Phx.

SECURITIES AND EXCHANGE COMMISSION, PLAINTIFF

v.

NATIONAL SECURITIES, INC., A CORPORATION, NATIONAL LIFE & CASUALTY INSURANCE COMPANY, A CORPORATION, ROBERT H. WALLACE, ROBERT C. BOHANNAN, JR., ARTHUR W. SAFFERT, TED WILKINS, JOHN S. BARRETT, JOSEPH B. SETTER, BRENFORD W. LARGE, JR. AND PRODUCERS LIFE INSURANCE COMPANY, A CORPORATION (ALSO KNOWN AS NATIONAL PRODUCERS LIFE INSURANCE COMPANY), DEFENDANTS.

ORDER ON DEFENDANTS' MOTION FOR JUDGMENT ON THE PLEADINGS OR, IN THE ALTERNATIVE, FOR SUMMARY JUDGMENT.

The cause having come before the Court upon defendants' motion for judgment on the pleadings or, in the alternative, for summary judgment; and the motion having been submitted for decision upon the record and briefs on file; and it appearing to the Court that:

[1] 1. A motion for judgment on the pleadings under Rule 12(c) of the Federal Rules of Civil Procedure raises the identical issue posed by a motion under Rule 12(b)(6), namely, whether the complaint states a claim upon which relief can be granted [see: *Friedman v. Washburn Co.*, 145 F.2d 715 (7th Cir.

1944); Art Metal Construction Co. for Use of McCloskey & Co. v. Lehigh Structural Steel Co., 116 F.2d 57 (3rd Cir. 1940); 1A Barron & Holtzoff, Federal Practice & Procedure § 359, p. 398];

2. Plaintiff's Amended and Supplemental Complaint alleges violations of § 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] and Rule 10b-5 promulgated thereunder [17 CFR 240.10b-5], arising from defendants' use of the mails in the solicitation of proxies for a proposed consolidation and reorganization of two stock insurance companies; the gist of the charge being that the solicitation material so mailed allegedly contained positive misrepresentations of material facts, and also failed to state material facts necessary to make the statements therein not misleading in light of the circumstances under which they were made;

3. The complaint prays for injunctive relief, and also demands—

That the Court enter a decree requiring and compelling the defendants and each of them to take all actions and measures which are necessary to rectify and correct the consequences of the wrongful and unlawful conduct of defendants as specified above and to restore Producers Life, National Life, their stockholders and the defendants to the status and economic condition which they occupied prior to April 27, 1964.

That the Court enter a decree requiring and compelling the defendants and each of them to make an accounting of the extent to which their actions and the actions of the selling directors in violation of Section 10(b) of the Act, 15 U.S.C. § 78j(b), and Rule 17 CFR 240.10b-5, and in derogation of the rights and interest of the stockholders of Producers Life, have resulted in damage to such stockholders, and the extent to which the defendants have

been unjustly enriched at the expense of such stockholders; and that, by suitable decree of the Court, the respective equities of the defendants and the stockholders of Producers Life be arranged and adjusted on a fair and equitable basis, including, if warranted on the basis of the accounting made by the defendants, the subordination of the stock interests and other equities of National Securities in National Producers to the interests of those stockholders whose equities have been diminished by reason of the unlawful and wrongful conduct of the defendants.

That the Commission may have all further relief that the Court may deem just, equitable, and necessary in the circumstances;

4. The acts complained of would fall within the prohibitions of the proxy-solicitation-anti-fraud provision of § 14 of the 1934 Act [15 U.S.C. § 78n], as implemented by Rule 14-9 [17 CFR 240.14a-9], but for the fact that the stock of the insurance companies involved has never been registered on any national securities exchange;

5. Not until sometime during 1966 will the coverage of § 14 be extended, by virtue of the act of August 20, 1964 [78 Stat. 569], to any corporation similarly situated to the insurance companies involved in this action; and then only if not exempted by new § 12(g)(2)(G) of the 1934 Act [15 U.S.C. § 78l(g)(2)(G)] which excludes "any security issued by an insurance company" provided the insurance company is subject to certain defined State regulation;

6. The legislative history of this new § 12(g)(2)(G) exemption includes, inter alia, the following:

This amendment was adopted following testimony by a number of State insurance commissioners and representatives of stock insurance companies who unanimously opposed the subjecting of these insurance com-

panies to the jurisdiction of the Securities and Exchange Commission in addition to the jurisdictions of the various State commissioners. Further, these witnesses opposed departure by the bill from the doctrine embodied in the McCarran Act that the regulation of insurance companies be left to the States. [House Report No. 1418, May 19, 1964; 1964 U.S. Code Cong., and Admin. News 3022];

7. Even if it be assumed that § 10(b) would otherwise be applicable to proxy solicitations [but see *Borak v. J. I. Case Co.*, unreported in the District Court, 317 F.2d 838, 846-847 (7th Cir. 1963), aff'd on other grounds, sub nom. *J. I. Case Co. v. Borak*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964)], and that a shareholder-approved corporate consolidation and reorganization is a "purchase or sale" of securities within the meaning of § 10(b) and Rule 10b-5 [compare *H. L. Green Co. v. Childree*, 185 F.Supp. 95 (S.D.N.Y.1960), and *Voegel v. American Sumatra Tobacco Corp.*, 241 F.Supp. 369 (D.Dela.1965), with *National Supply Co. v. Leland Stanford Jr. University*, 134 F.2d 689 (9th Cir. 1943), and *Sawyer v. Pioneer Mill Co.*, 190 F.Supp. 21 (D.Hawaii 1960), remanded 300 F.2d 200 (9th Cir. 1962), cert. den., 371 U.S. 814, 83 S.Ct. 24, 9 L.Ed.2d 55 (1962)], there still remains the question of whether the McCarran Act [59 Stat. 33, 15 U.S.C. §§ 1011-1015] does not preclude the application in this case of § 10(b), as implemented by Rule 10b-5;

8. 15 U.S.C. § 1012(b) states, in part:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance.

9. The law of Arizona requires that any proposed merger of stock insurance companies be submitted to

the Director of Insurance for his approval in accordance with the criteria set forth in A.R.S. § 20-731, which reads as follows:

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of Insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law,
2. Inequitable to the stockholders of any domestic insurer involved,
3. Would substantially reduce the security of service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

10. Arizona law further provides for an appeal to the State courts from a decision of the Director of Insurance made under the authority of A.R.S. § 20-731 [see A.R.S. §§ 20-161—20-166];

11. Moreover, the remedies which the Securities and Exchange Commission may seek in this Court are governed by § 21(e) of the 1934 Act, which provides:

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the

United States; to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter [15 U.S.C. § 78u(a)]; and

[2] 12. The allegations of the Amended and Supplemental Complaint at bar, if taken to be true, are insufficient to warrant issuance of an injunction against future violations of § 10(b) and Rule 10b-5, since the requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. § 20-731, would at least "impair", if not "invalidate" or "supercede", laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act [15 U.S.C. § 1012(b)]; and

[3] 13. Finally, plaintiff's demand for relief allegedly "necessary to rectify and correct the consequences of the wrongful and unlawful conduct of defendants", includes a prayer for an accounting for unjust enrichment and other relief, which would be inappropriate (cf. Note, 79 Harv.L.Rev. 656 (1966); but see; III Loss, Securities Regulation 1824-1829 (2nd Ed. 1961); Gary, Book Review, 75 Harv.L.Rev. 857, 861 (1962)] and would, in all events, fall outside the scope of available relief provided in § 21(e) of the 1934 Act [15 U.S.C. § 78u(e)];

Accordingly, it is ordered that defendants' motion for judgment on the pleadings is hereby granted.

It is further ordered that defendants serve and lodge with the Clerk of the Court, within ten days

Act of September 30, 1933, known as the Federal Trade Commission Act, and the Act of

from the date of this order, an appropriate form of judgment, which shall provide that plaintiff's action be dismissed without costs to any party, and that the judgment shall not constitute an adjudication upon the merits [Rule 41(b), Fed. Rules Civ. Proc.].

It is further ordered that the Clerk promptly serve copies of this order by United States mail upon the attorneys for the parties appearing in this cause.

(S) WM. O. MATTHEW,

Senior United States District Judge.

FEBRUARY 11, 1966.

APPENDIX C

RELEVANT STATUTES AND RULES

The McCarran-Ferguson Act, 59 Stat. 33-34, as amended, 15 U.S.C. 1011-1015, provides in pertinent part:

§ 1. Congress hereby declares that the continue regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 3. (a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the Act of

June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

§ 4. Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j, provides in pertinent part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 under the Securities Exchange Act of 1934, 17 CFR 240.10b-5, provides:

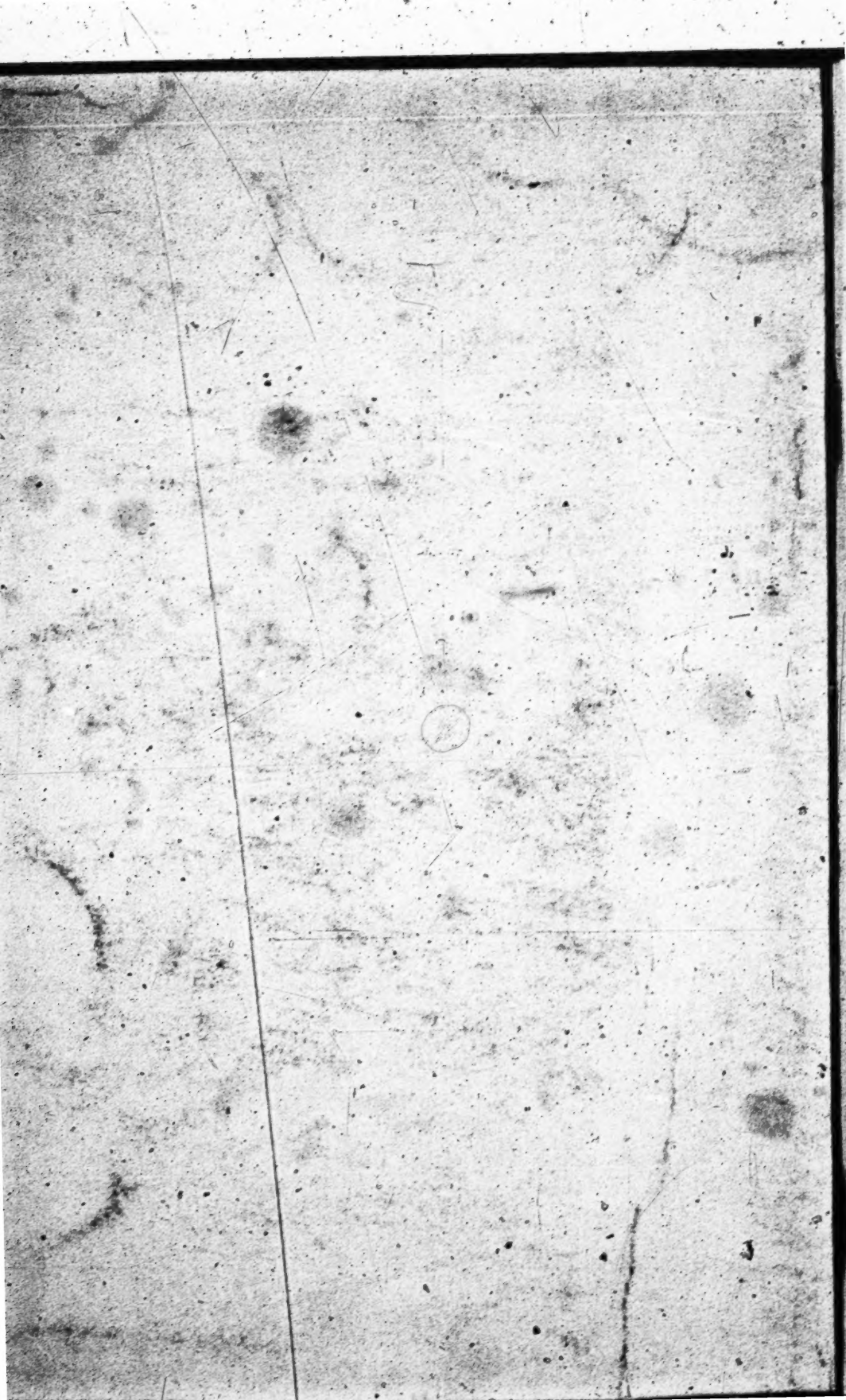
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the

mails or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.



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APR. 1. 1968

JOHN F. DAVIS, CLERK

No. 41

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1968

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

vs.

NATIONAL SECURITIES, INC., et al,
Respondent.

RESPONSE TO PETITION FOR CERTIORARI

LEWIS ROCA BEAUCHAMP & LINTON

By John P. Frank
114 West Adams
Phoenix, Arizona 85003
Attorneys for Respondent

SUBJECT INDEX

Page

OPINIONS BELOW 1

JURISDICTION 1

QUESTION PRESENTED 2

STATUTES AND RULE INVOLVED 2

STATEMENT 2

REASON FOR DENYING THE WRIT 6

I. Introduction 6

II. There is No Conflict of Decisions 7

III. This is an Isolated Question, and One
Which Will Probably Never Arise Again
in the United States 9

CONCLUSION 13

APPENDIX A 14

APPENDIX B 20

APPENDIX C 22

TABLE OF CASES AND AUTHORITIES CITED

Cases:	Page
<i>Allstate Ins. Co. v. Lanier</i> , 361 F.2d 870 (4th Cir. 1966)	9
<i>Federal Trade Commission v. National Casualty Co.</i> , 357 U.S. 560, 78 S. Ct. 1260, 2 L. Ed. 2d 1540 (1958)	8
<i>J. I. Case Co. v. Borak</i> , 377 U.S. 426, 84 S. Ct. 1555, 12 L. Ed. 2d 423 (1964)	12
<i>North Little Rock Transp. Co. v. Casualty Reciprocal Exch.</i> , 161 F.2d 174 (8th Cir. 1950)	8
<i>SEC. v. United Benefit Life Ins. Co.</i> , 387 U.S. 202, 87 S. Ct. 1557, 18 L. Ed. 2d 673 (1967)	9
<i>Securities and Exchange Commission v. Variable Annuity Ins. Co.</i> , 359 U.S. 65, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959)	7, 8
<i>Spiegel's Estate v. Comm'r</i> , 335 U.S. 701, 69 S. Ct. 301, 93 L. Ed. 330 (1949)	7
<i>Transnational Ins. Co. v. Rosenlund</i> , 261 F. Supp. 12 (D. Ore. 1966)	9
<i>United States v. Sylvanus</i> , 192 F.2d 96 (7th Cir. 1951), cert. denied, 342 U.S. 943, 72 S. Ct. 554, 96 L. Ed. 701 (1952)	9

Statutes and Rules:

Page

McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. §§ 1011-1015	2, 5, 6, 7, 10, 12
--	--------------------

Securities Exchange Act of 1934, 48 Stat. 891

§ 10(b), 15 U.S.C. § 78(j)(b)	1, 2, 11, 12
§ 12(g)(2)(G), 15 U.S.C. § 78l(2)(G)	11
§ 14(a), 15 U.S.C. § 78n(a)	5, 11, 12
§ 21(e), 15 U.S.C. § 78u(e)	5
28 U.S.C. § 1254(1)	1

Arizona Revised Statutes:

§ 20-143	12
§ 20-441	6
§ 20-443(3)	6
§ 20-444	6
§ 20-726.01	12
§ 20-731	6

Rules of the Supreme Court

Rule 12(3)	4
------------------	---

SEC Rule 10b-5, 17 C.F.R. 240.10b-5	1, 2, 11, 12
---	--------------

Arizona Insurance Dept. General Rules

Rule No. 66-12	12
----------------------	----

Other:

2 CCH Fed. Sec. L. Rep. ¶ 23,310	11
--	----

H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 3 (1964)	12
--	----

R. Stern & E. Gressman, <i>Supreme Court Practice</i> (3d ed. 1962)	10, 11
--	--------

U. S. GOVERNMENT PRINTING OFFICE
1963

No. 1201

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1967

SECURITIES AND EXCHANGE COMMISSION,

Petitioner,

vs.

NATIONAL SECURITIES, INC., et al, -

Respondent.

RESPONSE TO PETITION FOR CERTIORARI

The respondents request that the petition for certiorari in this matter be denied.

Opinions Below

The opinion of the District Court is reported at 252 F. Supp. 623, and the opinion of the Court of Appeals is reported at 387 F.2d 25.

Jurisdiction

The judgment of the Court of Appeals was entered on November 14, 1967. This Court has jurisdiction under 28 U.S.C. § 1254(1).

Question Presented

We cannot agree that the "question presented" as offered by the Government is the question actually presented to and decided by the court below. We therefore restate the question as follows:

Whether § 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 issued thereunder, read in the light of the McCarran-Ferguson Act, apply to allegedly false and misleading statements made in soliciting stockholder consents to a merger of insurance companies where the same matters have been before the State Director of Insurance who has approved the merger.

Statutes and Rule Involved

The relevant provisions of the McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. §§ 1011-1015; § 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b), and Rule 10b-5 of the General Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. 240.10b-5; the relevant provisions of the Securities Acts Amendments of 1964, 78 Stat. 565 (1964); and of the several applicable provisions of the statutes of Arizona are set forth in App. A.

Statement

In April, 1964, National Securities, Inc. (National Securities) held a controlling interest in an Arizona insurance company, National Life and Casualty Company (National Life). National Securities bought a substantial block of stock in a second Arizona insurance company, Producers Life Insurance Company (Producers). Neither National Life nor Producers was registered on

any national securities exchange, and their stock was traded over the counter.

Subsequent to the 1964 purchase, National Securities proposed a merger of the two insurance companies. A vigorous proxy fight occurred within Producers as to whether or not to agree to the merger, and there was a hardhitting proxy solicitation campaign, with much solicitation material (R. 567, *et seq.*, *passim*; R. 620).

On March 30, 1965, the SEC filed this action and obtained an *ex parte* restraining order (R. 108-11), the practical effect of which was to enjoin the merger. Speaking generally, the complaint was that there had been errors and omissions in the proxy solicitations (R. 9-11).

Proceedings on the SEC's application for a preliminary injunction were held on April 16, 1965. National Securities challenged the jurisdiction of the court, denied all allegations of any misleading statements, and also challenged the entire complaint as failing to state a claim. The District Court, on hearing, struck from the temporary restraining order all language which would preclude the merger (Order, R. 292).

In making this order, the District Court required a stipulation that if the stockholders voted for the merger, the matter would not be presented to the Arizona Director of Insurance for at least a week so that protests could be filed; and it was further stipulated that the company would give the SEC telegraphic notice at least one week before the matter would be presented to the Arizona Director so that the SEC might take any action it desired.

The stockholders then voted and the result was overwhelmingly in favor of the merger (R. 437-38). On April 27, 1965, the SEC was thus advised, and was told that

the merger would be presented to the Arizona Director. The Commission did not move for any stay of the cancellation of the operative portions of the temporary restraining order, nor did it apply to any higher court for relief. Instead, on April 28, the Commission wrote the Arizona Director of Insurance stating its view of the illegality of the proxy solicitation and forwarding to the Arizona Director all of the pleadings and evidentiary materials which had been before the Federal District Court.*

Under Arizona law, as will be more fully particularized below, a merger of insurance companies can occur only upon approval by the Arizona Director of Insurance, who is expressly required to consider stockholder as well as policyholder interests. Having had the opportunity to consider these matters, the Arizona Director of Insurance approved the merger (R. 800), and the surviving insurance company has since functioned as National Producers Life Insurance Company (National Producers).

On August 1, 1965, the SEC filed its amended and supplemental complaint for injunction (R. 423). The merger having been accomplished, it could no longer be

* These two paragraphs, showing the stipulation and the SEC's submission of the materials to the Arizona Director of Insurance, raise a problem of the record. The stipulation was set forth orally in the partial transcript of proceedings of April 16, 1965, pp. 15, 50-51; and it was confirmed in full detail, with references to all of the materials submitted by the SEC to the Arizona Director of Insurance in its own motion for reopening of the hearing on the preliminary injunction filed July 12, 1965, R. 390-97. These pages, though in the actual record, were not included in the designation which the SEC made for duplication of the record in the court below. We have therefore applied to have the original papers transmitted to this Court from the Court of Appeals in accordance with Rule 12(3), Rules of the Supreme Court.

enjoined; and the prayer for relief in essence called upon the defendants to undo it.

There were a number of issues before the District Court. Wholly apart from the McCarran Act question, the District Court adopted two independent grounds for decision in favor of the company.

1. The District Court found that the acts complained of would have fallen within the prohibitions of the proxy-solicitation-antifraud provision of § 14(a) of the 1934 Act but for the fact that the stock of the insurance company involved had never been registered on any national securities exchange; it found that the coverage of that section of the Act would not apply to the company until 1966, by virtue of the Act of August 20, 1964; and then only if the company were not within an exemption created by that Act. See Findings 4 and 5, set forth in the Government brief at p. 20a.

2. The District Court found that the remedy sought by the Commission was outside the scope of available relief provided in § 21(e) of the 1934 Act. (Government brief, p. 23a).

As a primary and independent ground of decision, the trial court found that the action was barred by the McCarran Act in that it would at least "impair" if not "invalidate" or "supersede" the laws of the State of Arizona regulating the business of insurance.

The Court of Appeals found it unnecessary to pass on any of the grounds other than the McCarran Act, and affirmed. However, it invoked the conclusions of the District Court on § 14(a) in respect to the prematurity of the SEC's attempt to invoke this power. The details of the Court of Appeals opinion will be considered in the Argument following.

Reasons for Denying the Writ

I. Introduction.

As we have noted in the Question Presented, this is one of those rare cases in which we must differ from the Government as to what the matter is about. The Government states the question in the broad, putting it generally as to whether the antifraud provisions of the Securities Exchange Act of 1934 can ever be applicable to false and misleading statements allegedly made in soliciting stockholder consents to a merger of insurance companies. But the District Court, and the Court of Appeals, and we, see the question more narrowly. As the Court of Appeals noted, Senator McCarran had said that "Congress held out an invitation to the states to deal affirmatively and effectively with those activities and practices of the insurance business which might otherwise be subject to federal regulation." Thereupon, Arizona expressly passed its little McCarran Act which did specify and govern illegal practices of insurance companies; A.R.S. § 20-441. Moreover, the Arizona Insurance Code expressly governs the conditions and standards of mergers of insurance companies, and puts as one of the issues to be determined by the State Director of Insurance whether the plan is "inequitable to the stockholders of any domestic insurer involved," and also whether it is contrary to law; A.R.S. § 20-731. The laws to which it might theoretically be contrary are Arizona fraud laws broad enough to cover misleading financial statements in proxy solicitations, A.R.S. § 20-441, 443(3), 444. As the Court of Appeals found,

"The State of Arizona has affirmatively asserted its power to regulate the merger of insurance companies. It has not merely deemed such mergers to be legal,

nor perfunctorily incorporated by reference its corporate merger provisions, but has set out additional standards and empowered a state agent to enforce them."

We are dealing with a plain question of local law, traditionally left to the lower courts to decide, *Spiegel's Estate v. Comm'r*, 335 U.S. 701, 707-08, 69 S. Ct. 301, 93 L. Ed. 330 (1949), but in this case obvious on the face of the statute.

In short, we have had an express, meditated decision by the State authorities of Arizona that these two insurance companies could merge and become one insurance company. The SEC had full opportunity to present these matters to the State authorities and, in fact, did so. The issue therefore is whether, when a state does make every effort to utilize all of the power over insurance companies which it has under the McCarran Act, it is to be allowed to do so.

II. There is No Conflict of Decisions.

No conflict is suggested, nor could there be such a suggestion. So nearly as has been discovered, there is no case dealing at all, in any direct sense, with the application of the McCarran Act to insurance company mergers. The spirit of the McCarran Act is recognized in the majority opinion in *Securities and Exchange Commission v. Variable Annuity Ins. Co.*, 359 U.S. 65, 68-69, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959), in which Justice Douglas for the Court said:

"We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements or transactions that are tailored to meet state

requirements. When the State speaks in the field of 'insurance,' they speak with the authority of a long tradition. For the regulation of 'insurance,' though within the ambit of federal power, (*United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 64 S. Ct. 1162, 88 L. Ed. 1440), has traditionally been under the control of the States." 359 U.S. at 68-69.

The legislative history is developed in the dissenting opinion in that same case, in language which we think a majority would equally accept; see 359 U.S. at 99, as follows:

"In 1944, this Court removed the supposed constitutional basis for exemption of insurance by holding, in *United States v. South-Eastern Underwriters Ass'n*, *supra*, that the business of insurance was subject to federal regulation under the commerce power. Congress was quick to respond. It forthwith enacted the McCarran Act, 59 Stat. 33, 15 U.S.C. §§ 1011-1015, 15 U.S.C.A. §§ 1011-1015, which on its face demonstrates the purpose 'broadly to give support to the existing and future state systems for regulating and taxing the business of insurance.' *Prudential Insurance Co. v. Benjamin*, *supra*, 328 U.S. at page 429, 66 S. Ct. at page 1155, and 'to assure that existing state power to regulate insurance would continue.' *Wilburn Boat Co. v. Fireman's Fund Ins. Co.*, *supra*, 348 U.S. at page 319, 75 S. Ct. at page 373. Thus, rather than encouraging Congress to enter the field of insurance, the *South-Eastern* decision spurred reiteration of its undeviating policy of abstention."

See also *North Little Rock Transp. Co. v. Casualty Reciprocal Exch.*, 181 F.2d 174 (8th Cir. 1950), upholding state rating bureaus in relation to the Sherman Act; *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560, 564, 78 S. Ct. 1280, 2 L. Ed. 2d 1540 (1958), on insurance company advertising in relation to the Federal

Trade Commission. As this Court said in the case just cited, "Petitioner does not argue that the statutory provisions here under review were mere pretense." The Court of Appeals has obviously echoed the same thought in the instant case by stressing that the Arizona regulation is substantial and not perfunctory.

We are not dealing with some question of Commission jurisdiction where an insurance company issues securities as well as sells insurance contracts; cf. *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 87 S. Ct. 1557, 18 L. Ed. 2d 673 (1967). Here we have nothing tangential or remote from the central function of insurance regulation. In the instant case, we deal with the bedrock question of the existence of an insurance company. Here these two Arizona insurance companies could merge and become one Arizona insurance company, or they could not. The determination of this question is at the very heart of the state regulatory function. As the Fourth Circuit has said, "Unless a Federal statute is made specifically applicable to the insurance business, it shall not 'invalidate, impair or supersede' any State insurance law." *Allstate Ins. Co. v. Lanier*, 361 F.2d 870 (4th Cir. 1966). The guiding principle is that "Where there is an applicable state statute, the federal Legislation does not apply." *Transnational Ins. Co. v. Rosenlund*, 261 F. Supp. 12, 26 (D. Ore. 1966).*

There is no conflict.

III. This is an Isolated Question, and One Which Will Probably Never Arise Again in the United States.

* Cf. *United States v. Sylvanus*, 192 F.2d 96 (7th Cir. 1951), cert. denied, 342 U.S. 943, 72 S. Ct. 554, 96 L. Ed. 701 (1952), in which the mail fraud act was held applicable to certain insurance policies, there being no suggestion that any state law was invalidated, impaired, or superseded.

There is no good in talking, as the Government does, about the volume of insurance company mergers. The question is, how many of them arise under anything like a legal system such as that operative here. The answer is very few; and, in any case, the relevant Act of Congress has been materially changed since this controversy arose.

1. The Government begins its argument with the observation that, "The traditional thrust of State insurance regulation has been the protection of policyholders, not stockholders." So far as mergers are concerned, this is only partially true. Ten states either have no or very limited insurance company merger provisions. Twenty-seven states require the approval of the insurance commissioner for mergers, but without specific mention of the rights of stockholders. (See App. B.)

Thirteen states, of which Arizona is one, require consideration of stockholder interest on mergers and also have antifraud provisions; see App. B. It follows that even theoretically a McCarran Act problem of the present sort could arise only in one of these thirteen states; and we do not know whether in these states such merger matters would in actual practice be seriously considered.

But we do know that we are not cited to one single illustration in any court or in any administrative agency, in which any McCarran-merger problem has ever arisen, except this case. It is indisputably unique, precisely what certiorari is not for; see illustratively the remarks of Chief Justice Vinson quoted in *R. Stern & E. Gressman, Supreme Court Practice* 120-21 (3d ed. 1962).

2. Not only has this question not arisen in the past, but because of a major change of law, it cannot arise in the future. While the particular case is still viable, the

legal issue has become virtually moot. Where the case depends on statutes which have since been changed, this Court would very rarely take the case even if there were a conflict, *R. Stern & E. Gressman, supra*, at 126-27.

This is an action to nullify a merger, allegedly because of improper proxy solicitations, brought under § 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j, and Rule 10b-5, issued under that Act (see App. A). On their face, at least, these sources do not deal with proxy solicitation at all. The proxy section is § 14(a) of the Act, 15 U.S.C. § 78n, which prior to the 1964 amendment made it illegal, in violation of the Rules of the Commission, to solicit proxies in respect of any security registered on any national securities exchange. The Commission could not and did not assert jurisdiction under the proxy rules over proxy solicitations relating to corporations whose securities were traded on the over-the-counter market; and most of the insurance companies, including these, were not registered on the exchanges.

Section 14 was extensively amended in 1964, 78 Stat. 569 (App. A). The amendment, which took effect in 1966, extended proxy controls to companies whose securities are sold over the counter, but exempted insurance companies where a substantially equivalent state regulation is in effect. (15 U.S.C. § 78l(2)(G), App. A). Upon the passage of that Act, the National Association of Insurance Commissioners prepared uniform proxy regulations for use by the insurance commissioners of each state, and all fifty states have now adopted either regulations or statutes to this general effect; see 2 CCH Fed. Sec. L. Rep., para. 23,310. Arizona thereupon adopted a comprehensive statute referring explicitly to the 1964

amendment, authorizing appropriate rulemaking, and regulating insider trading by officers, directors and principal stockholders; A.R.S. §§ 20-143 and 20-726.01. In pursuance of that statute, the Insurance Director issued general Rule No. 66-12 ("Regulations Regarding Proxies, Consents and Authorizations and Domestic Stock Insurers"), a regulation of some 5,000 words dovetailing into SEC controls.

(a) We do not believe that Rule 10b-5 ever did have any application to proxy solicitations and that this has always been a Rule 14(a) matter. The District Judge apparently thought so. See paras. 4 and 5 of his order, which the Court of Appeals quotes.* Certainly, as note 6 to the Court of Appeals opinion shows, the House Committee Report on the 1964 Amendments assumed that, in the light of the McCarran Act, the states should have the first opportunity to regulate proxy solicitations. This is overwhelmingly evident in the full House Report, and we attach all relevant material from that Report as App. C. The Commission in so many words told Congress that the amendment was needed, among other things, to deal with insurance mergers.** Nonetheless, Congress did expressly exempt insurance companies where the states undertook regulation.

(b) But the question just mentioned is no longer worth

* In *J. I. Case Co. v. Borak*, 377 U.S. 428, 84 S. Ct. 1555, 12 L. Ed. 2d 423 (1964), plaintiff alleged misleading proxy solicitations resting on both § 10(b) and § 14(a). The District Court held that § 10(b) did not apply to proxy solicitations, this being a § 14(a) matter. The Court held that § 14(a) gave a remedy, and did not consider the § 10(b) question.

** H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 3, at 40-41 (1964). Speaking of insurance companies, the Commission listed "mergers" as one of the examples of inadequate proxy controls.

answering. Whatever may have been the law as to proxy solicitations and mergers when this case arose, it is vastly different now. There will never again be a case on the validity and propriety of proxy solicitations for insurance company mergers in the absence of express state regulations because now, by the virtual direction of Congress, every state has such regulations. A decision of the point would not even dispose of this one isolated case, because there remain the other independent grounds, two of which were adopted by the District Court, for reaching the same result.

Conclusion

We cannot conceive how it would be possible more totally to "invalidate, impair, or supersede" a state insurance law than to determine that an insurance company may not exist when the State Director of Insurance has said that it may. This case is of course important to the parties, as all cases are; but in view of the total absence of conflict and the complete change in the law, it does not belong on the Supreme Court docket.

Respectfully submitted,

LEWIS ROCA BEAUCHAMP & LINTON

By John P. Frank
114 West Adams
Phoenix, Arizona 85003

March, 1968.

APPENDIX A

Relevant Statutes and Rules (Pertinent Portions)

1. McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C.

§ 1011-15:

§ 1. Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, that after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 3. (a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

§ 4. Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

2. Sec. 10(b), Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78:

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. Rule 10b-5 of the Securities and Exchange Comm., 17 C.F.R. 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or

deceit upon any person, in connection with the purchase or sale of any security.

4. Subsection C of the Securities Acts Amendments of 1964 amends Section 12 of the Securities Exchange Act of 1934 to require registration of equity securities of companies of a substantial sort which are traded over the counter. Its preface and subsection 2(G) follow, 78 Stat. 565, 567-68, 15 U.S.C. § 78l (2)(G):

"(2) The provisions of this subsection shall not apply in respect of—

"(G) any security issued by an insurance company if all of the following conditions are met:

"(i) Such insurance company is required to and does file an annual statement with the Commissioner of Insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer or agency substantially conforms to that so prescribed.

"(ii) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authorization in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.

"(iii) After July 1, 1966, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 16 of this title."

5. Relevant Arizona statutes:

(a) *Merger* (as it existed in 1965; irrelevant subsequent amendment), A.R.S. § 20-731

§ 20-731.

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director in insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.
3. Would substantially reduce the security of and service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

C. If the director does not approve the plan or agreement he shall so notify the insurer in writing specifying his reasons therefor.

(b) *Fraud*, A.R.S. § 20-441, 443(3), 444

§ 20-441.

Among the purposes of this article is the regulation of trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945, 59 Stat. 33, by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined.

§ 20-443.

No person shall make, issue or circulate, or cause to be made, issued or circulated, any estimate, illustration, circular or statement:

3. Making any misleading representation or any misrepresentation as to the financial condition of any insurer or as to the legal reserve system upon which any life insurer operates.

§ 20-444.

A. No person shall make, publish, disseminate, circulate or place before the public, or cause, directly or indirectly, to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio or television station, or in any other way, any advertisement, announcement or statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business, which is untrue, deceptive or misleading.

B. No person that is not an insurer shall assume or use any name which deceptively infers or suggests that it is an insurer.

(c) Proxy regulations, A.R.S. § 20-143(B)

B. The director shall make regulations concerning proxies, consents, or authorizations in respect of securities issued by domestic stock insurance companies having a class of equity securities held of record by one hundred or more persons to conform with the requirements of section 12(g) (2) (G) (ii) of the securities exchange act of 1934 as amended, and as may be amended. Such regulation shall not apply to any such company having a class of equity securities which are registered or are required to be registered pursuant to

section 12 of the securities exchange act of 1934, as amended, or as may be amended. Whenever such equity securities of any such company are registered or are required to be registered pursuant to section 12 of the securities exchange act of 1934, as amended, or as may be amended, then, no person shall solicit or permit the use of his name to solicit, in any manner whatsoever, any proxy, consent or authorization in respect of any equity security of such company without having first complied with the rules and regulations prescribed by the securities and exchange commission pursuant to section 14 of the securities exchange act of 1934 as amended, or as may be amended.

(d) *Insider trading*, A.R.S. § 20-726.01 is too extensive to reproduce, and is in any case relevant only in showing that Arizona did exercise the option given it in the 1964 amendment to the Securities Exchange Act of 1934.

APPENDIX B **LAWS OF THE FIFTY STATES** **RELATING TO** **INSURANCE COMPANY MERGERS**

Laws of States Which Require Insurance Department to Consider

Investor Interest on Mergers (Col. 2) and

Which also have Fraud Control Provisions (Col. 3)

State Name	Statute Number	Statute Number
Alaska	§ 21-69.590	§ 21-38.010, et seq.
Arizona	§ 20-731	§§ 20-441, 443(3), 444
Arkansas	§ 66-4245	§ 66-3005-3101
California	Cal. Ins. Code	Title 10
	§ 839	§ 2602.06 Cal.
		Admin. Code
Connecticut	§ 38-42	§ 38-56
Florida	§ 628.451	§ 626.0600
Idaho	§ 41-2856	§ 41-1301, et seq.
Montana	§ 40-4745	§ 40-3501, et seq.
Nevada	§ 682.320	§ 686.390, et seq.
Oklahoma	§ 36-2131	§ 36-1201, et seq.
Oregon	§ 732.540	§ 746.110
West Virginia	§ 33-5-25	§ 33-11-3
Wyoming	§ 26.1-510	§ 26.1-243, et seq.

**The Following States have no Specific
Provisions for the Approval of
Mergers by Insurance Departments**

Colorado
Delaware (except for mutual companies)
Maine (except for mutual companies)
Mississippi
New Hampshire
New Mexico
Rhode Island
South Carolina (except for mutual companies)
Tennessee (except fraternal societies)

**The Following States Require the Approval of
the Insurance Department or Superintendent for
Mergers, but Do Not Provide for
Specific Consideration of the
Rights of Stockholders**

State Name	Citation
Alabama	Title 10, § 94
Georgia	§ 56-1534
Hawaii	§ 181-651
Illinois	Title 73, § 774
Indiana	§ 39-3903
Iowa	Chap. 521
Kansas	§ 40-309
Kentucky	§ 304.951
Louisiana	§ 22-731
Maryland	Art. 48A, § 271
Massachusetts	Chap. 175, § 19A
Michigan	§ 500.7604
Minnesota	§ 60A.16(2)(1)(c)
Missouri	§ 376.520
Nebraska	§ 44-224.04
New Jersey	§ 152
New York	Art. 15, § 486
North Carolina	§ 58-155.1
North Dakota	§ 26-20-04
Ohio	§ 3907.11
Pennsylvania	T. 40, § 456
South Dakota	§ 31-16-38
Texas	§ 21.25
Utah	§ 31-28-1
Virginia	§ 38.1-81
Washington	§ 48.31.010
Wisconsin	§ 201.30

APPENDIX C

Excerpt from House Report
(Interstate and Foreign Commerce Committee)
No. 1418, May 19, 1964
[To accompany H.R. 6793]

(b) **Stock insurance companies.**—The bill, as introduced, would have covered stock insurance companies meeting the statutory standards. The committee amendment (to sec. 3(c) of the bill) exempts such a company from the jurisdiction of the Securities and Exchange Commission, but only if the company is regulated under State law or the State insurance commissions in all three of the following respects:

(1) Such insurance company is required to and does file an annual statement with the commissioner of insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer, or agency substantially conforms to that so prescribed.

(2) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authorizations in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.

(3) After July 1, 1966, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 16 of the Securities Exchange Act of 1934.

This committee amendment was adopted following testimony by a number of State insurance commissioners and representatives of stock insurance companies who

unanimously opposed the subjecting of these insurance companies to the jurisdiction of the Securities and Exchange Commission in addition to the jurisdictions of the various State Commissioners. Further, these witnesses opposed departure by the bill from the doctrine embodied in the McCarran Act that the regulation of insurance companies be left to the States. The basic objection advanced by these witnesses went not to the requirements for the protection of investors for disclosure but only to the jurisdictional question.

The State insurance commissioners through their organization, the National Association of Insurance Commissioners, testified that they recognized some validity to the contention in the commission's special study report that their procedures were primarily directed to matters concerning the protection of policyholders and to the need for some improvement in these procedures insofar as they relate to the protection of investors in the stock of these companies.

The thrust of the testimony by these representatives of the State insurance commissioners was that they be given an opportunity to demonstrate their ability effectively to protect the investors as well as the policyholders. The committee amendment gives these State commissioners this opportunity to do so.

The insurance regulatory authorities of all of the 50 States and the District of Columbia are members of this voluntary association, the National Association of Insurance Commissioners (NAIC), one of the major purposes of which is to achieve a substantial degree of uniformity in the regulation of the insurance business by the various States. NAIC has adopted a uniform annual reporting form, known as the convention blank (or convention

form annual statement), which, in turn, has been adopted in every State as the required annual report form for insurance companies. An NAIC committee, under the chairmanship of Mr. Stafford Grady, insurance commissioner for California, has recently developed also a "stockholders' information supplement" which will become an integral part of the basic form for 1964 and later years. The commissioners of each of the 50 States and the District of Columbia have advised the committee by letters that they would require insurance companies within their respective jurisdictions to file and comply with the supplement and any future revisions thereof as they are adopted by the association.

The purpose of this supplement (which is essentially a questionnaire) is to elicit whether the company's stockholders have been furnished information substantially equivalent to that which the Commission would require under its section 13 (periodic reporting) and section 14 (proxy) rules (although there is some difference in the financial information to be supplied, particularly reconciliation of income and surplus items). The committee amendment accordingly provides that the insurance companies may be exempt from the jurisdiction of the Commission provided that they are subject to State regulation meeting the standards prescribed by the National Association of Insurance Commissioners as to sections 13 and 14.

In addition, NAIC has undertaken a program to bring about enactment of a "model insider trading statute" in each of the 50 States and the District of Columbia which would afford investors protections comparable to those provided in section 16 of the Exchange Act. New York has already enacted the legislation and action is expected

in other States within the near future. The committee amendment would give the States 2 years to pass similar legislation, and provides that the insurance companies would be exempt from the jurisdiction of the Commission if the States have such statutes comparable to section 16.

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 1201

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

NATIONAL SECURITIES, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

1. The respondents attempt to belittle the importance of the question presented by asserting that this is the only case in which "any McCarran-merger problem has ever arisen" (Br. in Opp. 10). We describe in the footnote several pending insurance-company-merger cases under the antifraud provisions of the Securities Exchange Act of 1934 in which the effect of the McCarran-Ferguson Act has been raised.¹ The

¹ In *Mann v. Kuhn* (S.D. Ind., No. IP 64-6-455), the complaint (filed July 2, 1964, before the present case was instituted) alleged that policyholders' approval of a merger of insurance companies was solicited by false and misleading statements and omissions in violation of Section 10(b) of the Seca-

relative paucity of litigation on this issue, however, does not indicate that the question is unimportant. Rather, it reflects the fact that prior to the present case it generally was believed that McCarran-Ferguson did not create any immunity from the antifraud provisions of the federal securities acts for the purchase and sale of insurance company securities (see our petition, pp. 11-12, 17-18). The present decision is "indisputably unique" (Br. in Opp. 10) only in the sense that it marks the first time that "an appellate court has construed the McCarran-Ferguson Act as curities Exchange Act of 1934 and Rule 10b-5 thereunder. In moving for dismissal and summary judgment, the defendants argued that the McCarran-Ferguson Act "was intended to foreclose all federal statutes which might interfere with state regulatory programs" (brief filed November 6, 1964, p. 22). In a reply brief filed on March 18, 1966, the defendants relied upon the district court's decision in the present case (p. 22). Decision is pending.

In two cases seeking to enjoin the combination of two other insurance companies, the defendants relied upon the decision of the court of appeals in the present case: *Sample v. National Western Life Insurance Co.* (E.D. Mo., No. 67 C 423(3)); *Kunin v. Lewis* (E.D. Mo., No. 67 C 296(3)). In *Kunin* the court on January 3, 1968, denied a motion to dismiss; in *Sample* the court on January 8, 1968, entered a preliminary injunction against voting on the proposed combination.

See, also, the pending administrative proceeding before the Commission in *Pacific Insurance Company of New York and Bankers and Shippers Insurance Company of New York* (Administrative Proceeding File No. 3-982), in which applicants, in seeking an exemption from Section 17(a) of the Investment Company Act of 1940 for a non-merger transaction, argued that since the McCarran-Ferguson Act "reserves the regulation of insurance companies * * * to state law," the transaction should not be "subjected to regulation under the Investment Company Act of 1940" (applicants' brief before the Commission, pp. 43, 44).

stripping investors in insurance company securities of the protections against fraud that investors generally have under the federal securities laws. If the decision is permitted to stand, it will almost certainly lead to a substantial erosion of those protections for a significant class of investors.

2. The respondents further assert (Br. in Opp. 10) that the question "cannot arise in the future" because "the relevant Act of Congress has been materially changed since this controversy." But there has been no change in the statute under which the Commission proceeded in this case—Section 10(b) of the Securities Exchange Act of 1934, the antifraud provision. The change to which respondents refer involved Section 14 of the Act, which governs the solicitation of corporate proxies. The changes in the latter section neither lessened the importance of the Commission's authority under Section 10(b) to deal with fraud in the purchase and sale of insurance company securities,² nor reflected any congressional intent to leave the control of such fraud solely to State regulatory authorities.

a. Prior to 1964, Section 14 applied only to the solicitation of proxies for securities listed on a registered securities exchange. In 1964 Congress amended the Securities Act of 1934 to extend the coverage of the proxy provisions (as well as of certain other provisions) to securities of unlisted companies having assets of \$1,000,000 and more than 500 shareholders. 78

² As noted in our petition (p. 10, n. 6), the Commission consistently has treated securities transactions involved in a merger as a purchase and sale, and two courts of appeals recently have so held.

Stat. 567. The amendments except from such extended coverage, however, securities of insurance companies that are, *inter alia*, subject to specified regulation under State law that "conforms to that prescribed by the National Association of Insurance Commissioners." Following the 1964 amendments, most States adopted proxy regulations for insurance companies that met the Association's requirements.

Although such State regulatory provisions may be broad enough to cover fraud in connection with the solicitation of proxies for insurance company mergers, there is no assurance that the State authorities will apply the same comprehensive standards of fraud that have been developed under the federal securities acts, or will be able to give investors the same broad protection that the Securities and Exchange Commission can provide with its substantial staff and vast experience over many years in dealing with this frequently complex field. Indeed, in this very case the State insurance commissioner approved the merger under a statute which prohibits "untrue, deceptive or misleading" statements "with respect to the business of insurance," even though the Commission had submitted to him "all of the pleadings and evidentiary materials before the Federal District Court" (Br. in Opp. 4), which alleged that seriously false and misleading information was being used in soliciting stock-

* Securities Exchange Act, Section 12(g)(2)(G)(ii), 15 U.S.C. 78l(g)(2)(G)(ii).

* Arizona Revised Statutes §§ 20-444A, quoted Br. in Opp. 18.

- holder consents to the merger. Moreover, as shown in our petition (pp. 16-18), the rationale of the court of appeals is not limited to fraud committed in soliciting proxies for securities transactions in connection with insurance company mergers, but would cover all violations of the antifraud provisions involving insurance company securities. These provisions, of course, are not limited to proxy solicitations but comprehend all fraud committed in the purchase or sale of securities, and the jurisdiction of the State regulatory authorities over proxy solicitations would not provide any protection in this broader area for insurance company investors.

Finally, the courts have held that violations of Section 10(b) give rise to private causes of action.⁵ There is no assurance, however, that the courts of all the States will similarly recognize private remedies with respect to violations of the insurance commissioners' regulations. *Cf. J. I. Case Co. v. Borak*, 377 U.S. 426, 434-435.

b. The 1964 Securities Act Amendments, like the McCarran-Ferguson Act itself, did not curtail the application of the antifraud provisions of the federal securities acts to the purchase or sale of insurance company securities. Prior to the Amendments, as shown in our petition (pp. 11-12), it was regarded as settled that the antifraud provisions, which apply alike to listed and unlisted securities, covered insurance com-

⁵ See, e.g., *Vine v. Beneficial Finance Co.*, 374 F. 2d 627 (C.A. 2); *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 195 (C.A. 5); cf. *J. I. Case Co. v. Borak*, 377 U.S. 426.

pany securities. In the 1964 Amendments Congress in no way narrowed the scope of the Securities Exchange Act of 1934, or transferred to the States any of the functions previously performed by the Commission. On the contrary, Congress extended other provisions of the Act to cover some unlisted securities, but excepted from this extension of coverage securities of insurance companies subject to comparable regulation by the States. As far as those securities were concerned, therefore, the reach of the Securities Exchange Act of 1934 was no narrower after the 1964 Amendments than it had been before.

The respondent's contention thus blurs the distinction between the antifraud provisions of Section 10(b) and the recently amended proxy provisions of Section 14. Section 10(b) is directed against fraud in connection with the purchase or sale of securities, whether or not such fraud involves a proxy solicitation. Section 14 applies to all proxy solicitations (not exempted), whether or not they are related to any purchase, sale or exchange of securities. Because proxies are utilized in connection with many managerial activities of a company—activities that might be considered a part of "the business of insurance" as the term was used in the McCarran-Ferguson Act (Pet. 11-15)—there is no inconsistency between Congress' granting of the insurance exemption from the extension of general proxy regulations in 1964 and the continuation of the Commission's long-standing authority under Section 10(b) to protect all investors

against all forms of fraud in the specific area of purchases and sales of securities.*

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

PHILIP A. LOOMIS, Jr.,
General Counsel,
Securities and Exchange Commission.

APRIL 1968.

*There is also no inconsistency between the Commission's position in the present case and the fact that in 1964 the Commission listed "mergers" as among the examples of inadequate proxy controls over insurance companies (Br. in Opp. 12). Even though the antifraud provisions of Section 10(b) confer a jurisdiction that is in many respects broader than mere jurisdiction to regulate proxy solicitations, proxy regulation can supplement the § 10(b) jurisdiction in at least two ways: by conferring more definite authority to require affirmative disclosures in certain situations, and by providing a means of regulating mergers that may be consummated in the form of a purchase of assets without any exchange of securities.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes and rule involved	2
Statement	2
Summary of Argument	8
Argument:	
I. The McCarran-Ferguson Act does not immunize transactions in securities of insurance companies from the application of the federal securities laws	10
A. The federal securities laws have continuously been applicable to transactions in securities of insurance companies	13
B. The McCarran-Ferguson Act was concerned only with the possible effects of this Court's decision in <i>United States v. South-Eastern Underwriters Association</i> on State regulation of transactions in insurance policies and related business activities	17
II. The 1964 amendments to the federal securities laws are consistent with the Commission's contentions in this case	29
Conclusion	32
Appendix	33

CITATIONS

Cases:	
Alabama & N. O. Transportation Co. v. Doyle	210
Fed. 173	14
Bracey v. Darst	218 Fed. 482
Compco Corporation v. Day-Brite Lighting, Inc.	376
U.S. 234	23
Dasho v. Susquehanna Corp.	380 F. 2d 262, certiorari denied sub. nom. Bard v. Dasho, 389 U.S. 977
	11

Cases—Continued

<i>Federal Trade Commission v. Borden Co.</i> , 393 U.S. 637.	32
<i>Federal Trade Commission v. National Casualty Co.</i> , 357 U.S. 530.	21
<i>Federal Trade Commission v. Travelers Health Assn.</i> , 363 U.S. 293.	19, 21, 24
<i>Haynes v. United States</i> , 390 U.S. 85.	28
<i>Maryland Casualty Co. v. Oushing</i> , 347 U.S. 409.	24, 25
<i>National Supply Co. v. Leland Stanford Junior Uni- versity</i> , 134 F. 2d 689, certiorari denied, 320 U.S. 773.	11
<i>Paul v. Virginia</i> , 8 Wall. 108.	18
<i>Prudential Insurance Co. v. Benjamin</i> , 328 U.S. 408.	19
<i>Seare, Roebuck & Co. v. Stiffel Co.</i> , 376 U.S. 225.	23
<i>Securities and Exchange Commission v. Ralston Purina Co.</i> , 346 U.S. 119.	20
<i>Securities and Exchange Commission v. United Benefit Life Insurance Co.</i> , OCH Fed. Sec. L. Rep. ¶ 91,508 (D.D.C., March 23, 1965), 387 U.S. 202.	26
<i>Securities and Exchange Commission v. Variable Annuity Life Insurance Co., et al.</i> , 359 U.S. 65.	12, 26, 27
<i>Toberepin v. Knight</i> , 389 U.S. 332.	11
<i>United States v. South-Eastern Underwriters Associa- tion</i> , 322 U.S. 533.	9, 16, 18, 19, 20, 21, 22
<i>United States v. Byrum</i> , 192 F. 2d 96, certiorari denied, 342 U.S. 943.	25
<i>Vine v. Beneficial Finance Company</i> , 374 F. 2d 627, certiorari denied, 380 U.S. 970.	11
<i>Wilburn Boat Co. v. Fireman's Ins. Co.</i> , 348 U.S. 310.	19
Statutes and rule:	
Investment Company Act of 1940, 54 Stat. 789, et seq., 15 U.S.C. 80a-1 et seq.:	
Section 3(c), 15 U.S.C. 70a-3(c)(3)	15
Section 8, 15 U.S.C. 80a-8	17
Investment Advisers Act of 1940, 54 Stat. 847, et seq., U.S.C. 80b-1 et seq.:	
Section 202(b)(2), 15 U.S.C. 80b-3(b)(2)	15
Ariana Revised Statutes:	
Section 20-442, 20-447, 20-731	13
Merchant Marine Act, 1920, 41 Stat. 983, 46 U.S.C. 558, 558a-1, 558a-2	23

Statutes and rule—Continued

McCarran-Ferguson Act, 50 Stat. 33-34, 15 U.S.C. 1011-1015

Section 1, 15 U.S.C. 1011	22, 33
Section 2(a), 15 U.S.C. 1012(a)	22, 33
Section 2(b), 15 U.S.C. 1012(b)	2, 3, 20, 22, 25, 33
Section 3, 15 U.S.C. 1013	19, 22, 33
Section 4, 15 U.S.C. 1014	7, 22, 34
Section 5, 15 U.S.C. 1015	27

Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77a

et seq.:

Preamble	14
Section 3(a)(8), 15 U.S.C. 77c(a)(8)	15
Section 6, 15 U.S.C. 77f	16

Securities Exchange Act of 1934, 48 Stat. 881, 15

U.S.C. 78a *et seq.*:

Section 2, 15 U.S.C. 78b	14
Section 3(a)(10), 15 U.S.C. 78c(a)(10)	11
Section 10(b), 15 U.S.C. 78j (b)	2, 3, 11, 14, 25, 29, 30, 31, 34
Section 12, 15 U.S.C. 78l	16
Section 12(g)(2)(G)(ii), 15 U.S.C. 78l(g)(2)(G)(ii)	29
Section 14, 15 U.S.C. 78n	30
Section 15(b), 15 U.S.C. 78o(b)	16
Section 21(e), 15 U.S.C. 78u(e)	7

Rule 10b-5, 17 CFR 240.10b-5

Securities Act Amendments of 1964, 78 Stat. 565

Telegraph and Telephone Tax Act, 26 U.S.C. 4251,

et seq.

Trust Indenture Act of 1939, 53 Stat. 1149, as

amended, 15 U.S.C. 77aaa *et seq.*:

Section 302(a)(4), 15 U.S.C. 77ddd(a)(4)	15
26 U.S.C. 3111	23

Miscellaneous:

Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1939	17
First Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1935	16
H. Rep. No. 85, 73d Cong., 1st Sess. (1933)	15
H. Rep. No. 143, 79th Cong. 1st Sess. (1945)	19, 24

Miscellaneous—Continued

H. Rep. No. 1418, 88th Cong., 2d Sess. (1964)

29

Hearings Before the Committee on Banking and Currency on S. 875, a Bill to Provide for the Furnishing of Information and the Supervision of Traffic in Investment Securities in Interstate Commerce, 73d Cong., 1st Sess. (1933)

13, 14

Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 6789, H.R. 6793, S. 1642, 88th Cong., 1st Sess. (1963)

27

Huebner and Black, *Life Insurance* (6th ed, 1964)

18

Loss and Cowett, *Blue-Sky Law* (1958)

12

S. Rep. No. 20, 79th Cong., 1st Sess. (1945)

19

S. Rep. No. 379, 88th Cong., 1st Sess. (1963)

28

Securities Act Release No. 3965 (1958)

11

Securities Act Release No. 4115 (1959)

11

Security Dealers of North America (1968 ed.)

16

Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941

17

Sixteenth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1950

17

Twenty-fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1959

17

Twenty-Fourth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1958

17

Trust Indenture Act of 1939, 55 Stat. 1148, 48 Stat. 1148, 16 U.S.C. 77aaa et seq.

13

23

Miscellaneous: First Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1933

17

First Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1933

18

H. Rep. No. 733, 73d Cong., 1st Sess. (1933)

15

H. Rep. No. 1418, 88th Cong., 2d Sess. (1964)

24

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 41

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

NATIONAL SECURITIES, INC., ET AL

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT**

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The opinion of the district court (App. 139-144) is reported at 252 F. Supp. 623. The opinion of the court of appeals (App. 148-161) is reported at 387 F. 2d 25.

JURISDICTION

The judgment of the court of appeals was entered on November 14, 1967 (App. 162). On February 10, 1968, Mr. Justice Douglas extended the time for filing a petition for a writ of certiorari to and including March 4, 1968. The petition was filed on the latter date, and was granted on April 22, 1968 (App. 163). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the McCarran-Ferguson Act—Section 2(b) of which provides that no act of Congress shall “invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to” that business—precludes the application of the antifraud provisions of the Securities Exchange Act of 1934 to false and misleading statements made in soliciting stockholder consents to a merger of insurance companies.

STATUTES AND RULE INVOLVED

The relevant provisions of the McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. 1011-1015, Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), and Rule 10b-5 of the Securities and Exchange Commission, 17 CFR 240.10b-5, are set forth in the Appendix, *infra*, pp. 33-35.

STATEMENT

The Securities and Exchange Commission instituted this action in the United States District Court for the District of Arizona in March 1965, to enjoin respondents National Securities, Inc., its subsidiary National Life and Casualty Insurance Company, and certain officers and employees of one or both of these companies from violating Section 10(b) of the Securities Exchange Act of 1934 and the Commission's Rule 10b-5 thereunder (App. 11-24) which generally prohibit fraud in connection with the purchase or sale

of securities. The district court dismissed the suit on the pleadings (App. 145) and the court of appeals affirmed on the ground that the action was barred by the McCarran-Ferguson Act, Section 2(b) of which provides (App., *infra*, p. 83):

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, unless such Act specifically relates to the business of insurance.

1. The Commission's amended complaint made the following allegations—which the court of appeals stated "must be presumed by us to be true" (App. 154):

National Securities is a holding company which owned two-thirds of the 1,018,574 outstanding shares of National Life, an insurance company incorporated in Arizona. Producers Life Insurance Company, another insurance company incorporated in that State, had 881,976 outstanding shares of common stock, held by approximately 14,000 stockholders in many States. The defendants formed an illegal scheme, in violation

Section 10(b) makes it unlawful to use, in connection with the purchase or sale of any security in interstate commerce or through the mails, "any manipulative or deceptive device or contrivance" in contravention of the Commission's rules. Rule 10b-5 makes it unlawful, in connection with such purchase or sale, "to employ any device, scheme, or artifice to defraud," "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, not misleading," or to engage "in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." App., *infra*, p. 81.

of the antifraud provisions of the Act, by which (a) National Securities would acquire control of Producers Life, (b) National Life and Producers Life would be consolidated, and (c) the consolidated company would pay a large part of National Securities' cost of acquiring control of Producers Life (App. 82-86).

As a step in obtaining control of Producers Life, National Securities purchased the stock of that company held by four of Producers Life's directors, and agreed to pay them large sums in return for their agreement not to compete with Producers Life or any successor company. At the same time National Securities purchased from Producers Life more than 50,000 shares of its treasury stock, and assumed liabilities of Producers Life of some \$600,000 stemming from prior agreements of other persons not to compete with it (App. 85-86). National Securities did not

* Under the terms of the consolidation agreement, each stockholder of Producers Life was to receive an additional share of Producers Life stock for every five shares owned. The ratification by the stockholders of Producers Life of the issuing of this stock was made a condition precedent to the consolidation agreement. The agreement further provided that each shareholder of National Life would receive one share of Producers Life stock for each share of National Life owned by him. The consolidation agreement, in addition, provided that the consolidated company would be known as National Producers Life Insurance Company. Although the shareholders of Producers Life did not actually surrender their certificates, upon the execution of the consolidation agreement (pursuant to ratification by them) their interests and rights were materially changed (App. 86).

National Securities purchased 50,906 shares of treasury stock for \$2.00 per share, and also assumed liabilities payable over approximately eight years of \$697,801. National Securities'

disclose to Producers Life or its stockholders that it intended to impose these liabilities upon the corporation that would result from the planned consolidation of Producers Life and National Life (App. 90-91).

After obtaining control of Producers Life, National Securities caused the latter to mail to its stockholders material soliciting them to approve the proposed consolidation with National Life. This material was false and misleading because, among other things:

a. It did not disclose the amount of National Securities' liability on the agreements not to compete—more than \$1,400,000—which was to become a continuing charge against the income of the consolidated company (App. 90-91).

b. It repeatedly predicted that the consolidated company would have net earnings of more than \$460,000 annually, but did not disclose that Producers Life and National Life had had losses in the prior year (1964) of approximately \$70,000 and \$35,000, respectively (App. 47, 84, 95-96, 117, 119, 122, 124, 127, 129).

c. It set forth in the pro-forma balance sheet for the consolidated company an asset known as "Treasury Stock \$1,174,556" that was "illusory" (App. 51, 93-94).

simultaneous purchase of 27,418 shares of Producers Life from four of the latter's directors was at \$20.79 per share, and its purchase from a company controlled by the same directors of 38,894 shares of Producers Life was at \$9.50 per share. In addition, the four directors were to be paid \$979,000 over the next ten-year period for their agreements not to compete (App. 88-89).

2. It did not disclose that in its 1964 Annual Report to the Arizona Insurance Commission, National Life had written down on its books the value of its stockholdings in Producers Life from \$1,164,000 to \$641,658 (App. 96, 130, 131, 133).

2. Upon the filing of the Commission's action, the district court entered a preliminary restraining order which, as subsequently modified, barred the defendants generally from violating the antifraud provisions of the Act, but permitted them to submit the consolidation plan to the stockholders for approval (App. 96-97). The stockholders accepted the plan, the Arizona Insurance Commissioner approved it and the defendants effected the consolidation (App. 96-98). The Commission then filed an amended and supplemental complaint in which it requested broader relief than it originally had sought (App. 98-100).

* In addition to the injunction previously sought, the Commission requested that the defendants be required "to take all actions and measures which are necessary to rectify and correct the consequences of the [ir] wrongful and unlawful conduct . . . and to restore Producers Life, National Life, their stockholders and the defendants to the status and economic conditions which they occupied prior to April 27, 1964 [the date of the alleged agreement between National Securities, Producers Life and the four selling directors thereof]"; that the defendants "make an accounting of the extent to which their [illegal] actions and the [illegal] actions of the selling directors . . . have resulted in damage to such stockholders, and the extent to which the defendants have been unjustly enriched at the expense of such stockholders"; and that "by suitable decree of the Court, the respective equities of the defendants and the stockholders of Producers Life be arranged and adjusted on a fair and equitable basis, including, if warranted on the basis of the accountings made by the defendants, the subordination of the stock interests and other equities of Na-

In granting the defendants' motion for judgment on the pleadings, the district court held (1) that the McCarran-Ferguson Act precluded the "requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance" (App. 143); and (2) that the Commission's request for "an accounting for unjust enrichment, and other relief . . . would be inappropriate . . . and would, in all events, fall outside the scope of available relief provided in § 21(e) of the 1934 Act" (App. 144).

The court of appeals affirmed on the ground that the McCarran-Ferguson Act barred the action, and did not pass upon the propriety of the relief that the Commission sought. The court stated that in the McCarran-Ferguson Act Congress "define[d] an exemption for insurance conterminous with its power to regulate interstate commerce"; that the legislative history of that Act disclosed "a general intention to set the insurance business outside the scope of all existing and future legislation regulating interstate commerce, without any more direct evidence that Congress had in mind the Securities Exchange Act"; that the provision in Section 4 of the McCarran-Ferguson Act "relates to the interests of those stockholders whose equities have been diminished by reason of the unlawful and wrongful conduct of the defendants" (App. 98-100).

Section 21(e) authorizes the Commission to bring an action in the district court to "enjoin such acts or practices" as appear to the Commission to violate the Act or its rules thereunder, and provides that "upon a proper showing a permanent or temporary injunction or restraining order shall be granted . . ." 15 U.S.C. 78u(e).

Act making it inapplicable to the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act, 1920, indicated that Congress believed that, otherwise, the application of those statutes to the business of insurance would be suspended; that "the commerce clause was not to be used as a springboard for federal regulation in the absence of a specific statutory reference to insurance"; and that in the McCarran-Ferguson Act Congress wished "to preserve intact from any federal intrusion based on the commerce clause, existing and future State regulation of the insurance industry." (App. 156-157.) The court concluded its opinion with the statement that it was "in accord with" the following "views expressed by the district court":

[T]he requested relief of invalidation by this Court of the corporate merger, now finally approved by the Arizona Director of Insurance pursuant to A.R.S. §20-731, would at least "impair", if not "invalidate" or "supercede" (sic) laws enacted by the State of Arizona "for the purpose of regulating the business of insurance", within the meaning of the applicable provisions of the McCarran Act. [App. 161.]

SUMMARY OF ARGUMENT

Investors and prospective investors in securities of insurance companies have the same need for the protections of the federal securities laws as investors in other businesses. The holding of the court below that the McCarran-Ferguson Act deprives investors in insurance stocks of these protections creates a serious gap in the comprehensive scheme of securities regulation.

that Congress designed to benefit the entire investing public.

The applicability of the federal securities laws to transactions in insurance company securities was firmly established long before the decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, to which the McCarran-Ferguson Act was directed. The application of those laws to such transactions has continued without abatement since the enactment of the McCarran-Ferguson Act, and thus has become a matter of settled administrative and industry practice. This regulatory jurisdiction was never dependent on whether transactions in insurance policies were considered to be interstate commerce subject to congressional regulation under the Commerce Clause; it was based instead on the proposition that the securities themselves were subjects of interstate commerce which Congress could regulate and on congressional power to regulate the use of the mails.

The legislative history of the McCarran-Ferguson Act makes clear that the Act's exclusive purpose was to counteract possible adverse effects that the decision in *South-Eastern Underwriters* might otherwise have had on the previously established power of the States to regulate and tax the business of insurance. Careful consideration of the Act as a whole demonstrates that it must be interpreted in light of, and restricted to, this legislative purpose in order to avoid unwarranted distortion of the intention of Congress. Because the previously established applicability of the federal securities laws to transactions in insurance company securities was entirely unaffected by the *South-*

Eastern Underwriters decision, it remains undiminished by the McCarran-Ferguson Act. This Court has implicitly so held in decisions upholding the applicability of the federal securities laws to transactions in variable annuities, and Congress has explicitly indicated its understanding that these laws continue to apply to insurance company securities.

The 1964 amendments to the federal securities laws in no way diminished the applicability of those laws to transactions in insurance company securities. The insurance exemptions in those amendments are limited to requirements newly imposed by the amendments and are entirely consistent with a congressional purpose to preserve unimpaired the protections previously afforded investors in insurance company securities.

ARGUMENT

I

THE MCCARRAN-FERGUSON ACT DOES NOT IMMUNIZE TRANSACTIONS IN SECURITIES OF INSURANCE COMPANIES FROM THE APPLICATION OF THE FEDERAL SECURITIES LAWS

The court of appeals held, in effect, that the anti-fraud provisions of the Securities Exchange Act of 1934 were partially repealed by the McCarran-Ferguson Act. The court's reasoning would appear to be similarly applicable to other provisions of both the Securities Exchange Act and the Securities Act of 1933 (48 Stat. 74, 15 U.S.C. 77a *et seq.*). This holding creates a serious gap in the comprehensive investor protections that Congress provided in the federal securi-

ties laws and is, we submit, an erroneous interpretation of the McCarran-Ferguson Act.

In Section 3(a)(10) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(10), Congress adopted a broad definition of "security" in order "to protect investors through the requirement of full disclosure by issuers of securities" (*Tcherepnin v. Knight*, 389 U.S. 332, 336). Section 10(b) of that Act makes it unlawful to use any manipulative or deceptive device or contrivance "in connection with the purchase or sale of *any* security registered on a national securities exchange or *any* security not so registered" (emphasis added). In the face of this clear congressional intent to extend the antifraud provisions to all sales and purchases of securities—and for many years the Commission has regarded an exchange of securities such as was involved in the consolidation of National Life and Producers Life as constituting a "purchase" or "sale" of securities under the antifraud provisions of the Securities Exchange Act of 1934 and the Securities Act of 1933—an exception to the general broad scope of this important public legislation should not be created by implication unless it is clearly required by

* See Securities Act Release Nos. 3965 (1958), 4115 (1959). The courts of appeals for the Second and Seventh Circuits recently upheld the Commission's position on this question. *Vine v. Beneficial Finance Company*, 374 F. 2d 627 (C.A. 9), certiorari denied, 389 U.S. 970; *Dasho v. Susquehanna Corp.*, 380 F. 2d 262 (C.A. 7), certiorari denied *sub nom. Bard v. Dasho*, 389 U.S. 977. Twenty-five years ago the Ninth Circuit stated the contrary. *National Supply Co. v. Leland Stanford Junior University*, 134 F. 2d 689, certiorari denied, 320 U.S. 773.

some other federal statute. The McCarran-Ferguson Act, as we shall show below, was not intended to create such an exception.

The need to protect stockholders against such misrepresentations as were allegedly made in connection with the consolidation of National Life and Producers Life is no less compelling for investors in insurance companies than for investors in other businesses. The traditional thrust of State insurance regulation has been the protection of policy holders, not stockholders. Of *Securities and Exchange Commission v. Variable Annuity Life Insurance Co., et al.*, 359 U.S. 65, 78-79 (concurring opinion of Mr. Justice Brennan). Even when State regulatory provisions may be broad enough to cover fraud in connection with transactions in securities of insurance companies, State experience and resources in the general area of stockholder protection tend to be both limited and divided between the officials administering the "blue sky" laws and those administering the insurance laws. There is no assurance that the State authorities will apply the same comprehensive standards of fraud that have been developed under the federal securities acts, or will be able to give investors the same broad protection that the Securities and Exchange Commission can provide with its substantial staff and vast experience over many years in dealing with this frequently complex field. Indeed, in this very case the State insurance commissioner approved the merger under a statute which prohibits "untrue, deceptive or misleading" statements "with respect to the business

¹ See, generally, Loss and Cowett, *Blue Sky Law* (1958).

of insurance," even though the Commission had submitted to him "all of the pleadings and evidentiary materials which had been before the Federal District Court" (Br. in Opp. 4), which alleged that seriously false and misleading information was being used in soliciting stockholders' consents to the merger.

A. THE FEDERAL SECURITIES LAWS HAVE CONTINUOUSLY BEEN APPLICABLE TO TRANSACTIONS IN SECURITIES OF INSURANCE COMPANIES

The issuer of securities need not be engaged in interstate commerce in order for the federal securities laws to be applicable to transactions in the securities.*

* Arizona Revised Statutes § 20-444A.

Although the respondent has contended that provisions in the Arizona Insurance Code may be broad enough to cover misleading financial statements in proxy solicitations (Br. in Opp. 6), the provisions to which respondent has referred are directed toward unfair practices and frauds in the transaction of an insurance business. The sections which respondent has cited appear in a chapter of the Arizona Revised Statutes entitled, "Transaction of Insurance Business," and in an article entitled, "Unfair Practices and Frauds," under captions such as "Misrepresentations and false advertising of policies," "False or deceptive advertising of insurance or status as insurer," and "False financial statements or records." Arizona Revised Statutes §§ 20-441 to 20-447. There is nothing to indicate that either these provisions or those relating to mergers in the Insurance Code (Arizona Revised Statutes § 20-781), the latter of which are not a part of Arizona's "Little McCarran Act," give the Director of Insurance jurisdiction to determine whether full disclosure has been made in connection with the solicitation of proxies.

* For example, the purpose specified in the preamble to the Securities Act of 1933 is: "To provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." 48 Stat. 74. Section 2

In enacting the securities laws, Congress relied on the fact that court decisions had treated securities themselves as subjects of interstate commerce. A *Study of the Economic and Legal Aspects of the Proposed Federal Securities Act*, prepared by the Department of Commerce and set forth in an Appendix to the Senate Committee Hearings, quoted from *Alabama & N. O. Transportation Co. v. Doyle*, 210 Fed. 173, 182 (E.D. Mich.): "

"We cannot doubt that stocks and bonds are now the subject of interstate commerce, and that shipments and sales of them, between the states, are interstate commerce."

In addition, the postal powers were relied upon as a basis for applying the federal statutes to securities transactions, such as those here, which involved the use of the mails. The very provision in question here, Section 10(b) of the Securities Exchange Act, has as its jurisdictional base "the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange".

of the Securities Exchange Act specifically notes that not all securities transactions dealt with by that Act are those of issuers engaged in interstate commerce: "Such transactions * * *

(c) involve in large part the securities of issuers engaged in interstate commerce" (emphasis supplied). 15 U.S.C. 79b.

"Hearings Before the Committee on Banking and Currency on S. 875, a Bill to Provide for the Furnishing of Information and the Supervision of Traffic in Investment Securities in Interstate Commerce, 73d Cong., 1st Sess. 229, 230 (1929). The Study also quoted from *Bracey v. Darst*, 218 Fed. 489, 495 (E.D. West Va.): "We do not think it can longer be questioned that stocks, bonds, debentures, and other securities are subject-matters of interstate commerce." *Ibid.*

Hence, from the outset, the Federal securities laws were drafted with a breadth that excluded transactions by insurance companies or others in securities of insurance companies as well as other businesses, regardless of whether transactions in insurance policies were considered subject to congressional regulation under the Commerce Clause (see point I.B, *infra*). That Congress recognized and intended this result is reflected on the face of the statutes themselves, not only in their broad definition of "security" (see *supra*, p. 11), but also in the exemption provisions explicitly dealing with the subject of insurance.

The Securities Act of 1933 provided an exemption in Section 3(a)(8), 15 U.S.C. 77c(a)(8), for an "insurance or endowment policy or annuity contract, issued by a corporation subject to the supervision of the insurance commissioner". This exemption was incorporated by reference in Section 202(a)(4) of the Trust Indenture Act of 1939, as amended, 15 U.S.C. 77ddd(a)(4). Section 3(c)(3) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(3), excepted from the definition of an investment company "[a]ny . . . insurance company". Finally, Section 203(b)(2) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(b)(2), excepted from the requirement of registration with the Securities and

This exemption was to make clear what is already implied in the act, namely, that insurance policies are not to be regarded as securities subject to the act. The insurance policy and like contracts are not regarded in the securities laws as securities offered to the public for investment. H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933).

Exchange Commission "any investment adviser whose only clients are insurance companies."

"Except to the limited extent set forth above, Congress did not exempt insurance companies or their securities from the federal securities laws. Accordingly, both prior to this Court's decision in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, and subsequent to the enactment of the McCarran-Ferguson Act, issues of insurance companies' securities were registered under Section 6 of the Securities Act of 1933, 15 U.S.C. 77f; "the securities of insurance companies listed on national exchanges were registered with the Commission under Section 12 of the Securities Exchange Act of 1934, 15 U.S.C. 78l; "persons who buy and sell insurance companies' securities were registered under Section 15(b) of the Securities Exchange Act, 15 U.S.C. 78o(b); "invest-

"Sec. 87. First Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1935, p. 77. Registration Statement under the Securities Act of 1933 filed by National Life and Casualty Insurance Company with the Securities and Exchange Commission on September 28, 1933 (File No. 2-10488). Frodox Life Insurance Company has filed the following notification of offerings of securities pursuant to Regulation A under the Securities Act of 1933: File No. 24SF-117 (filed May 11, 1930), File No. 24SF-1711 (filed January 20, 1932) and File No. 24SF-2620 (filed June 8, 1930).

"The following brokers and dealers, who are registered with the Securities and Exchange Commission pursuant to Section 15(b) of the Securities Exchange Act of 1934, hold themselves out as specialists in insurance company securities: Midland, Colquhoun Company (File No. 2-2074); State Co. (File No. 2-2074); J. J. Lang Company (File No. 2-214); The Security Dealers of North America (1932-33) and O. B. B. Co. (1931-32).

ment companies with portfolios consisting of insurance companies' securities were registered under Section 9 of the Investment Company Act, 15 U.S.C. § 80a-8, and persons selling insurance companies' securities in violation of anti-fraud provisions of the securities acts were enjoined or convicted or their registrations as broker-dealers were revoked."

B. THE MCCARRAN-FERGUSON ACT WAS CONCERNED ONLY WITH THE POSSIBLE EFFECTS OF THIS COURT'S DECISION IN UNITED STATES V. SOUTH-EASTERN UNDERWRITERS ASSOCIATION ON STATE REGULATION OF TRANSACTIONS IN INSURANCE POLICIES AND RELATED BUSINESS ACTIVITIES.

Historically, such matters as the chartering and licensing of insurance companies; insurance rates; the content, form and issuance of insurance policies; advertising and sales practices in insurance; the maintenance of proper reserves; and the prevention of un-

"E.g., Life Insurance Investors, Inc. (File No. 811-602); Insurance and Bank Stock Fund, Inc. (File No. 811-836); Insurance Investors Fund, Inc. (File No. 811-786); Life Insurance Stock Fund, Inc. (File No. 811-600).

"See, e.g., Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1939, p. 250, respecting transactions in stock of Surrogate Life Insurance Company; Seventh Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1941, p. 233, respecting transactions in stock of Texas Mutual Reserve Life Ins. Co.; Sixteenth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1950, p. 207, respecting transactions in stock of Co-op Insurance Co.; Twenty-Fourth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1958, p. 231, respecting transactions in stock of Great Fidelity Life Insurance Co.; Twenty-Fifth Annual Report of the Securities and Exchange Commission, Fiscal Year Ended June 30, 1959, p. 270, respecting transactions in stock of American Buyers Insurance Co. and Unity Insurance Co.

fair practices by insurance companies in dealing with their policy holders have been regulated by the States." The constitutional power of the federal government to regulate the business of insurance had long been subject to serious doubt under the doctrine of *Paul v. Virginia*, 8 Wall. 168, 183, where the Court said:

Issuing a policy of insurance is not a transaction of commerce. The policies are simple contracts of indemnity against loss by fire, entered into between the corporations and the assured, for a consideration paid by the latter. These contracts are not articles of commerce in any proper meaning of the word. * * *

In *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, a case involving the application of the Sherman Act to fire insurance premium rates fixed by agreement, it was recognized that, "In all cases in which the Court has relied upon the proposition that 'the business of insurance is not commerce,' its attention was focused on the validity of state statutes—the extent to which the Commerce Clause automatically deprived states of the power to regulate the insurance business." *Id.* at 544. Because "legal formulae devised to uphold state power cannot unthinkingly be accepted as trustworthy guides to determine Congressional power under the Commerce Clause" (*id.* at 545), this Court held that the doctrine of *Paul v. Virginia* was no bar to its determination that "insurance transactions which stretch across state boundaries and affect interstate commerce are within the power of Congress to regulate." *Id.* at 545. *See* *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, 545 (1944), pp. 533-545.

state lines constitute "Commerce among the several states" so as to make them subject to regulation by Congress under the Commerce Clause. 322 U.S. at 538-539.

The McCarran-Ferguson Act was passed "in order to make necessary adjustments to this decision." S. Rep. No. 20, 79th Cong., 1st Sess. 1 (1945). See, also, H. Rep. No. 143, 79th Cong., 1st Sess. 2 (1945). The Act's "basic purpose was to allay doubts thought to have been raised by this Court's decision of the previous year in *United States v. South-Eastern Underwriters Assn.*, 322 U.S. 533, as to the continuing power of the States to tax and regulate the business of insurance." *Federal Trade Commission v. Travelers Health Assn.*, 362 U.S. 293, 299. See, also, *Wilburn Boat Co. v. Fireman's Ins. Co.*, 348 U.S. 810, 819; *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 429-431. Congress intended to "stabilize the general situation," and this was accomplished in part by "declar[ing] that * * * continued regulation and taxation by the several States of the business of insurance is in the public interest; and * * * by suspending the application of the Sherman and Clayton Acts for approximately two sessions of the State legislatures, so that the States and the Congress may consider legislation during that period." S. Rep. No. 20, 79th Cong., 1st Sess. 2 (1945); H. Rep. No. 143, 79th Cong., 1st Sess. 2, 3 (1945).² The objective of pre-

² Section 3 of the Act also suspended for a like period the application of the Federal Trade Commission Act and the Robinson-Patman Act to the business of insurance. 45 U.S.C. 1013.

serving the favored position of State regulation of insurance as it had existed prior to the *South-Eastern Underwriters* decision was further effectuated in Section 2(b) of the Act, which provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating [or taxing or imposing a fee upon] the business of insurance, * * * unless such Act specifically relates to the business of insurance * * *." This is the provision at issue here.

1. Because Congress did not define the phrase "the business of insurance" as used throughout the McCarran-Ferguson Act, the meaning of that phrase must be determined by reference to the basic purpose and design of the legislation and the problems with which Congress was concerned. Cf. *Securities and Exchange Commission v. Ralston Purina Co.*, 346 U.S. 119. As already noted, the focus of Congress' attention and concern was this Court's holding in *South-Eastern Underwriters* that interstate sales of insurance policies and business activities related thereto constitute interstate commerce subject to congressional regulation under the Commerce Clause. But the federal securities laws, enacted ten years prior to *South-Eastern Underwriters*, had continuously been applicable to transactions in securities of insurance companies (see supra, pp. 13-17)—and such transactions were considered to be no more beyond the reach of congressional power than transactions in securities of other companies. Nothing in the history or language of the McCarran-Ferguson Act indicates any congressional intent to reexamine this previously established federal

regulatory jurisdiction over securities transactions. The Act was wholly a response to the *South-Eastern* decision, in which the phrase "the business of insurance" was prominently used in the Court's opinion (see *supra*, p. 18).

In addressing itself to regulation of "the business of insurance" in that Act, therefore, Congress was referring to those activities of insurance companies which, under the constitutional interpretation prevailing prior to *South-Eastern Underwriters*, had been thought to be immune from federal regulation under the Commerce Clause and thus had been exclusively the subject of State regulation (except as they might collaterally be affected by the exercise of other congressional powers, *e.g.*, in the copyright, tax or postal laws). These included such matters as rates, the content, form and issuance of policies, the maintenance of proper reserves, the prevention of unfair practices in dealing with policyholders (cf. *Federal Trade Commission v. National Casualty Co.*, 357 U.S. 560), etc. It was only with respect to those matters—the "business of insurance"—that Congress intended partially to preclude the application of federal legislation and to preserve the favored status of State regulation because it was only in those areas that any threat of interference with settled State practices was posed by the *South-Eastern Underwriters* decision.

2. The *South-Eastern Underwriters* decision posed only two categories of "doubts" . . . as to the continuing power of the States to tax and regulate the business of insurance" (*Federal Trade Commission v. Travelers Health Assn.*, *supra*, 362 U.S. at 299). One

category resulted from the fact that the Commerce Clause, of its own force, has been held to impose limitations on State regulation and taxation of interstate commerce even when Congress has been silent. Congress addressed itself to those "doubts" in Sections 1 and 2(a) of the McCarran-Ferguson Act. The second category of "doubts" arose from the possibility that Acts of Congress generally applicable to interstate commerce would now be construed to apply to "the business of insurance" and thereby "to invalidate, impair, or supersede" State regulation previously thought to be immune from that threat. This is the question to which the remainder of the Act, including Section 2(b), was addressed.

Plainly, the threat that an Act of Congress might "invalidate, impair, or supersede" State law was posed by the *South-Eastern Underwriters* decision only to the extent that the federal statute would not affect "the business of insurance" but for the holding in that case that such business constitutes interstate commerce. Federal statutes whose effect on "the business of insurance" did not depend on the holding in *South-Eastern Underwriters* were simply outside the range of congressional concern or intention in the enactment of the McCarran-Ferguson Act. This is demonstrated not only by the Act's legislative history (see *supra*, pp. 19-20; *infra*, p. 24), but also by consideration of the Acts of Congress that were particularly specified on the face of the statute and those that were not. Sections 2(b), 3 and 4 of the Act contain special provisions relating to the Sherman Act, Clayton Act, Federal Trade Commission Act, Robin-

son-Patman Act, National Labor Relations Act and Fair Labor Standards Act—all of which seemed applicable to insurance companies only to the extent to which "the business of insurance" was regulable under the Commerce Clause." But no mention was made of numerous federal statutes—such as copyright and patent laws, certain tax laws," counterfeit-ing laws, postal laws, or the federal securities laws—which do not expressly relate to insurance but which always had been applied to those engaged in the business of insurance without regard to whether that business was considered regulable under the Commerce Clause. It simply would not have occurred to those who enacted the McCarran-Ferguson Act that anyone could think that the Act would, for example, enable a State: (1) to permit an insurance company to infringe a federally granted copyright or patent, or to grant an insurance company similar monopoly rights not authorized by the federal copyright or patent laws (cf. *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225; *Compco Corporation v. Day-Brite Lighting, Inc.*, 376 U.S. 234); (2) to excuse an insurance company from its obligations to pay federal taxes

"The only arguable exception is the Merchant Marine Act, 1920, 41 Stat. 988, 46 U.S.C. 886 (specified in Section 4 of the McCarran-Ferguson Act). An exemption from the antitrust laws was provided in Section 29(b) of that Act for associations of marine insurance companies, and the Act therefore may have been expressly excepted from the McCarran-Ferguson Act to make clear that this exemption would continue to apply even after the McCarran-Ferguson Act moratorium on the antitrust laws had expired.

"See, e.g., 26 U.S.C. 4251 et. seq. (Telegraph and Telephone Tax Act); 26 U.S.C. 3111 (social security tax).

in order to increase the company's reserves; (8) to authorize an insurance company to print counterfeit money in order to pay insurance claims that it is otherwise unable to meet; or (4) to allow an insurance company to use the mails to defraud stockholders in connection with the purchase or sale of securities. Any of these results would be directly contrary to the intention clearly expressed in the House Report on the Bill as enacted (H. Rep. No. 143, 79th Cong., 1st Sess. 3):

It is not the intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *South-eastern Underwriters Association* case. * * *

This language in the House Report was relied upon as "decisive" in an opinion joined by four members of this Court which adopted the interpretation of the McCarran-Ferguson Act we now advocate. *Maryland Casualty Co. v. Cushing*, 347 U.S. 409, 413 (opinion of Mr. Justice Frankfurter). In a passage which a majority of this Court later specifically cited with apparent approval and endorsement (*Federal Trade Commission v. Travelers Health Assn.*, *supra*, 362 U.S. at 299), that opinion stated that "even the most cursory reading of the legislative history of this enactment [McCarran-Ferguson Act] makes it clear that its exclusive purpose was to counteract any adverse effect that this Court's decision in *United States v. South-Eastern Underwriters Association*, 322 U.S.

533, might be found to have on State regulation of insurance." (347 U.S. at 413.) Because the issue in *Cushing* was "not touched by the *South-Eastern Underwriters* case", the McCarran-Ferguson Act was deemed "not relevant" (*ibid.*).²¹ As we have shown above, the question of the applicability of the federal securities laws to transactions in insurance companies' securities was likewise "not touched by the *South-Eastern Underwriters* case."²²

²¹ There was more reason in *Cushing* than in the present case to refer to the policy underlying the McCarran-Ferguson Act for guidance in construing a federal statute so as to avoid a direct conflict with State law. See 347 U.S. at 432-438 (dissenting opinion of Mr. Justice Black); cf. 347 U.S. at 423-427 (concurring opinion of Mr. Justice Clark). Section 10(b) of the Securities Exchange Act of 1934 does not conflict with the Arizona insurance law, but is supplementary and collateral to it. The Commission's suit in no way sought to alter or modify any of the requirements that State law imposes upon insurance companies; its objective was solely to prevent misrepresentations in securities transactions and to obtain effective relief for shareholders who had been injured thereby. Surely this would not "invalidate, impair, or supersede" State insurance regulation within the meaning of Section 2(b) of the McCarran-Ferguson Act. As stated in the text above, however, we contend more broadly that a proper interpretation of the McCarran-Ferguson Act would preclude the possibility that a State, by any structuring of its insurance law, could immunize those dealing in securities of insurance companies from the applicability of the antifraud provisions of the federal securities laws.

²² Indeed, in *United States v. Sylvanus*, 192 F. 2d 90 (C.A. 7), *certiorari denied*, 342 U.S. 943, the court upheld, in a situation where, as here, the use of the mails provided the jurisdictional basis for the application of the statute, a conviction for mail fraud committed in connection with the sale of accident and sickness insurance policies. The argument that the indictment was barred by the McCarran-Ferguson Act was specifically rejected (192 F. 2d at 100): "[W]e believe that it can not properly be said that this indictment has to do with the regula-

3. The interpretation of the McCarran-Ferguson Act advocated herein has already been adopted implicitly by this Court in the context of securities regulation in *Securities and Exchange Commission v. United Benefit Life Insurance Co.*, 381 U.S. 202, where, as the opinion points out, the respondent was "in the main . . . an insurance company exempt from the requirements of the Investment Company Act" (*id.* at 212). It had been urged in that case that the McCarran-Ferguson Act barred the application of the Securities Act of 1933 to the transactions in variable annuity contracts there involved.¹ In ruling that the variable annuities were "securities" subject to the 1933 Act, this Court necessarily determined that the McCarran-Ferguson Act did not bar the application of the federal securities laws to transactions in securities of insurance companies.

The respondent in the *United Benefit* case was supervised by the Director of Insurance of the State of Nebraska and by insurance commissioners of other States in which it was authorized to do business.² Similarly, in *Securities and Exchange Commission v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 94, as pointed out in the dissenting opinion, the companies there involved were "organized under the Life Insurance of [the] insurance business in Illinois. Rather it has to do with the question of whether defendants have used the mails in pursuance of a scheme so to manipulate their authorized regulated business in Illinois as to result in fraudulent deception of its prospective policy holders."

See trial for respondent, No. 223, 1965 Term, pp. 23, 42-43. ¹ See also dissenting opinion in *Securities and Exchange Commission v. United Benefit Life Insurance Company*, CCH Fed. Sec. L. Rep. ¶91,908 (D.D.C., March 22, 1965).

² See trial for respondent, No. 223, 1965 Term, pp. 23, 42-43. ³ See also dissenting opinion in *Securities and Exchange Commission v. United Benefit Life Insurance Company*, CCH Fed. Sec. L. Rep. ¶91,908 (D.D.C., March 22, 1965).

ance Act of the District of Columbia, and [were] subject to regulation by the Superintendent of Insurance of the District of Columbia, who approved the annuity policies written by them." Because this Court found the variable annuities sold were basically securities, it held that their sale was subject to the Securities Act of 1933 and that the companies issuing such securities, as well, were subject to the Investment Company Act of 1940, notwithstanding the supervision of the State insurance authorities and the respondents' contentions that they were immunized from federal regulation by the McCarran-Ferguson Act (see 359 U.S. at 67-68).

4. Congress, as well as this Court, has indicated its understanding that the applicability of the federal securities laws to transactions in securities of insurance companies was unimpaired by the McCarran-Ferguson Act. When amendments to the federal securities laws were being considered in 1963, the Commission filed a statement with the House Committee which summarized the relationship of insurance companies with the federal securities laws up to that time, as follows:*

Historically, insurance companies have never been exempted from either the Securities Act of 1933 or the Securities Exchange Act of 1934. Under the Securities Act of 1933, an insurance company distributing its securities to the public must file a registration statement with the Com-

* The District of Columbia is a "State" within the meaning of the McCarran-Ferguson Act (15 U.S.C. 1015).

** Hearings Before a Subcommittee of the House Committee on Interstate and Foreign Commerce on H.R. 6789, H.R. 6798, S. 1642, 88th Cong., 1st Sess. 176 (1963).

mission and comply with all of the provisions of that act, in the same manner as any industrial company. Likewise, under the Securities Exchange Act, an insurance company listing a security on a national securities exchange must comply with all of the provisions of that act applicable to exchange-listed companies. Presently two insurance companies have a security so listed and comply with those provisions of the act. Moreover, section 15(d) of the Exchange Act, added to that act in 1936, is fully applicable to insurance companies. That section requires an issuer distributing its securities to the public under a Securities Act registration statement to file periodic financial and other reports with the Commission if the value of the securities offered plus the value of all other outstanding securities of the class offered exceeds \$2 million. Under section 15(d), approximately 148 insurance companies, including about 96 life insurance companies, file periodic reports with the Commission.

When the amendments were reported out of committee in the course of their adoption, the Senate Committee on Banking and Currency specifically stated, "Stock insurance companies are presently subject to the provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934."

The holding of the court below to the contrary is unwarranted.

S. Rep. No. 379, 88th Cong., 1st Sess. 36 (1963). Although the views of the Congress that enacted the 1934 legislation "provide no controlling basis from which to infer the purposes of an earlier Congress" that passed the McCarran-Ferguson Act, such views nevertheless are "pertinent." See *Haynes v. United States*, 390 U.S. 85, 87-88, n.4, 71-72, 161-62.

THE 1964 AMENDMENTS TO THE FEDERAL SECURITIES LAWS ARE CONSISTENT WITH THE COMMISSION'S CONTENTIONS IN THIS CASE

In 1964, Congress enacted amendments to the Securities Exchange Act, to take effect in 1966, which require registration of the equity securities of the larger over-the-counter companies and extend reporting, proxy, and insider-trading provisions to such companies. Securities Acts Amendments of 1964, 78 Stat. 565. The amendments except from such extended coverage, however, securities of insurance companies that are, *inter alia*, subject to specified regulation under State law that "conforms to that prescribed by the National Association of Insurance Commissioners."

Congress determined that as to these matters, State insurance commissioners should "be given an opportunity to demonstrate their ability effectively to protect the investors as well as the policyholders."

These exemptions are limited solely to the expanded application of the requirements relating to periodic reports, proxies, and insider-trading and do not purport to affect other requirements imposed by the various federal securities laws, such as the antifraud prohibitions of Section 10(b) of the Securities Exchange Act. Section 10(b) is, of course, not limited to proxy solicitations but comprehends all fraud committed in the purchase or sale of securities, and the

"Securities Exchange Act, Section 12(g)(2)(G)(ii), 15 U.S.C. 78j(g)(2)(G)(ii).

H. Rep. No. 1413, 88th Cong., 2d Sess. 10 (1964).

jurisdiction of the State regulatory authorities over proxy solicitations would not provide any protection in this broader area for insurance company investors.

Prior to the 1964 amendments, as we have shown (*supra*, pp. 16-17, 27-28), it was regarded as settled that the antifraud provisions, which apply alike to listed and unlisted securities, covered insurance company securities. Because the amendments in no way narrowed the scope of the Securities Exchange Act of 1934, they did not transfer to the States any of the functions previously performed by the Commission. On the contrary, Congress extended other provisions of the Act to cover some unlisted securities, but excepted from this extension of coverage securities of insurance companies subject to comparable regulation by the States. As far as those securities are concerned, therefore, the reach of the Securities Exchange Act of 1934 can be no narrower after the 1964 amendments than it was before.

There are fundamental distinctions between the anti-fraud provisions of Section 10(b) and the recently extended proxy provisions of Section 14 (15 U.S.C. 78n). Section 10(b) is directed against fraud in connection with the purchase or sale of securities, whether or not such fraud involves a proxy solicitation. Section 14 applies to all proxy solicitations (not exempted), whether or not they are related to any purchase, sale or exchange of securities. Because proxies are utilized in connection with many managerial activities of a company—some of which might be considered a part of "the business of insurance" as the term was used in the McCarran-Ferguson Act

(see *supra*, pp. 20-21)—there is no inconsistency between Congress' granting of the insurance exemption from the extension of general proxy regulations in 1964 and the continuation of the Commission's long-standing authority under Section 10(b) to protect all investors against all forms of fraud in the specific area of purchases and sales of securities."

³⁰ There is also no inconsistency between the Commission's position in the present case and the fact that in 1964 the Commission listed "mergers" as among the examples of inadequate proxy controls over insurance companies (Br. in Opp. 12). Even though the antifraud provisions of Section 10(b) confer a jurisdiction that is in many respects broader than mere jurisdiction to regulate proxy solicitations, proxy regulation can supplement the Section 10(b) jurisdiction in at least two ways: by conferring more definite authority to require affirmative disclosures in certain situations, and by providing a means of regulating mergers that may be consummated in the form of a purchase of assets without any exchange of securities.

Securities and Exchange Commission

JULY 1968

The district court held that the relief the Commission sought (see report pp. 6-7) was not authorized by the statute and would be inappropriate (App. 141). The court of appeals did not decide the question. If this Court reverses on the *Madison-Ferguson* Act issue, it should remand for the court of appeals to consider the relief question and the other issues ordered by the parties that it did not decide. *Madison-Ferguson* v. Board of Governors of the Federal Reserve System, 383 U.S. 163, 167 (1966).

That the Act of 1934, which was amended in 1938, 1940, 1942, 1945, 1946, 1947, 1948, 1950, 1952, 1953, 1954, 1955, 1956, 1957, 1958, 1959, 1960, 1961, 1962, 1963, 1964, 1965, 1966, 1967, 1968, 1969, 1970, 1971, 1972, 1973, 1974, 1975, 1976, 1977, 1978, 1979, 1980, 1981, 1982, 1983, 1984, 1985, 1986, 1987, 1988, 1989, 1990, 1991, 1992, 1993, 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, 2022, 2023, 2024, 2025, 2026, 2027, 2028, 2029, 2030, 2031, 2032, 2033, 2034, 2035, 2036, 2037, 2038, 2039, 2040, 2041, 2042, 2043, 2044, 2045, 2046, 2047, 2048, 2049, 2050, 2051, 2052, 2053, 2054, 2055, 2056, 2057, 2058, 2059, 2060, 2061, 2062, 2063, 2064, 2065, 2066, 2067, 2068, 2069, 2070, 2071, 2072, 2073, 2074, 2075, 2076, 2077, 2078, 2079, 2080, 2081, 2082, 2083, 2084, 2085, 2086, 2087, 2088, 2089, 2090, 2091, 2092, 2093, 2094, 2095, 2096, 2097, 2098, 2099, 2100, 2101, 2102, 2103, 2104, 2105, 2106, 2107, 2108, 2109, 2110, 2111, 2112, 2113, 2114, 2115, 2116, 2117, 2118, 2119, 2120, 2121, 2122, 2123, 2124, 2125, 2126, 2127, 2128, 2129, 2130, 2131, 2132, 2133, 2134, 2135, 2136, 2137, 2138, 2139, 2140, 2141, 2142, 2143, 2144, 2145, 2146, 2147, 2148, 2149, 2150, 2151, 2152, 2153, 2154, 2155, 2156, 2157, 2158, 2159, 2160, 2161, 2162, 2163, 2164, 2165, 2166, 2167, 2168, 2169, 2170, 2171, 2172, 2173, 2174, 2175, 2176, 2177, 2178, 2179, 2180, 2181, 2182, 2183, 2184, 2185, 2186, 2187, 2188, 2189, 2190, 2191, 2192, 2193, 2194, 2195, 2196, 2197, 2198, 2199, 2200, 2201, 2202, 2203, 2204, 2205, 2206, 2207, 2208, 2209, 2210, 2211, 2212, 2213, 2214, 2215, 2216, 2217, 2218, 2219, 2220, 2221, 2222, 2223, 2224, 2225, 2226, 2227, 2228, 2229, 2230, 2231, 2232, 2233, 2234, 2235, 2236, 2237, 2238, 2239, 2240, 2241, 2242, 2243, 2244, 2245, 2246, 2247, 2248, 2249, 2250, 2251, 2252, 2253, 2254, 2255, 2256, 2257, 2258, 2259, 2260, 2261, 2262, 2263, 2264, 2265, 2266, 2267, 2268, 2269, 2270, 2271, 2272, 2273, 2274, 2275, 2276, 2277, 2278, 2279, 2280, 2281, 2282, 2283, 2284, 2285, 2286, 2287, 2288, 2289, 2290, 2291, 2292, 2293, 2294, 2295, 2296, 2297, 2298, 2299, 2300, 2301, 2302, 2303, 2304, 2305, 2306, 2307, 2308, 2309, 2310, 2311, 2312, 2313, 2314, 2315, 2316, 2317, 2318, 2319, 2320, 2321, 2322, 2323, 2324, 2325, 2326, 2327, 2328, 2329, 2330, 2331, 2332, 2333, 2334, 2335, 2336, 2337, 2338, 2339, 2340, 2341, 2342, 2343, 2344, 2345, 2346, 2347, 2348, 2349, 2350, 2351, 2352, 2353, 2354, 2355, 2356, 2357, 2358, 2359, 2360, 2361, 2362, 2363, 2364, 2365, 2366, 2367, 2368, 2369, 2370, 2371, 2372, 2373, 2374, 2375, 2376, 2377, 2378, 2379, 2380, 2381, 2382, 2383, 2384, 2385, 2386, 2387, 2388, 2389, 2390, 2391, 2392, 2393, 2394, 2395, 2396, 2397, 2398, 2399, 2400, 2401, 2402, 2403, 2404, 2405, 2406, 2407, 2408, 2409, 2410, 2411, 2412, 2413, 2414, 2415, 2416, 2417, 2418, 2419, 2420, 2421, 2422, 2423, 2424, 2425, 2426, 2427, 2428, 2429, 2430, 2431, 2432, 2433, 2434, 2435, 2436, 2437, 2438, 2439, 2440, 2441, 2442, 2443, 2444, 2445, 2446, 2447, 2448, 2449, 2450, 2451, 2452, 2453, 2454, 2455, 2456, 2457, 2458, 2459, 2460, 2461, 2462, 2463, 2464, 2465, 2466, 2467, 2468, 2469, 2470, 2471, 2472, 2473, 2474, 2475, 2476, 2477, 2478, 2479, 2480, 2481, 2482, 2483, 2484, 2485, 2486, 2487, 2488, 2489, 2490, 2491, 2492, 2493, 2494, 2495, 2496, 2497, 2498, 2499, 2500, 2501, 2502, 2503, 2504, 2505, 2506, 2507, 2508, 2509, 2510, 2511, 2512, 2513, 2514, 2515, 2516, 2517, 2518, 2519, 2520, 2521, 2522, 2523, 2524, 2525, 2526, 2527, 2528, 2529, 2530, 2531, 2532, 2533, 2534, 2535, 2536, 2537, 2538, 2539, 2540, 2541, 2542, 2543, 2544, 2545, 2546, 2547, 2548, 2549, 2550, 2551, 2552, 2553, 2554, 2555, 2556, 2557, 2558, 2559, 2560, 2561, 2562, 2563, 2564, 2565, 2566, 2567, 2568, 2569, 2570, 2571, 2572, 2573, 2574, 2575, 2576, 2577, 2578, 2579, 2580, 2581, 2582, 2583, 2584, 2585, 2586, 2587, 2588, 2589, 2590, 2591, 2592, 2593, 2594, 2595, 2596, 2597, 2598, 2599, 2600, 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3597, 3598, 3599, 3600, 3601, 3602, 3603, 3604, 3605, 3606, 3607, 3608, 3609, 3610, 3611, 3612, 3613, 3614, 3615, 3616, 3617, 3618, 3619, 3620, 3621, 3622, 3623, 3624, 3625, 3626, 3627, 3628, 3629, 3630, 3631, 3632, 3633, 3634, 3635, 3636, 3637, 3638, 3639, 3640, 3641, 3642, 3643, 3644, 3645, 3646, 3647, 3648, 3649, 3650, 3651, 3652, 3653, 3654, 3655, 3656, 3657, 3658, 3659, 3660, 3661, 3662, 3663, 3664, 3665, 3666, 3667, 3668, 3669, 3670, 3671, 3672, 3673, 3674, 3675, 3676, 3677, 3678, 3679, 3680, 3681, 3682, 3683, 3684, 3685, 3686, 3687, 3688, 3689, 3690, 3691, 3692, 3693, 3694, 3695, 3696, 3697, 3698, 3699, 3700, 3701, 3702, 3703, 3704, 3705, 3706, 3707, 3708, 3709, 3710, 3711, 3712, 3713, 3714, 3715, 3716, 3717, 3718, 3719, 3720, 3721, 3722, 3723, 3724, 3725, 3726, 3727, 3728, 3729, 3730, 3731, 3732, 3733, 3734, 3735, 3736, 3737, 3738, 3739, 3740, 3741, 3742, 3743, 3744, 3745, 3746, 3747, 3748, 3749, 3750, 3751, 3752, 3753, 3754, 3755, 3756, 3757, 3758, 3759, 3760, 3761, 3762, 3763, 3764, 3765, 3766, 3767, 3768, 3769, 3770, 3771, 3772, 3773, 3774, 3775, 3776, 3777, 3778, 3779, 3780, 3781, 3782, 3783, 3784, 3785, 3786, 3787, 3788, 3789, 3790, 3791, 3792, 3793, 3794, 3795, 3796, 3797, 3798, 3799, 3800, 3801, 3802, 3803, 3804, 3805, 3806, 3807, 3808, 3809, 3810, 3811, 3812, 3813, 3814, 3815, 3816, 3817, 3818, 3819, 3820, 3821, 3822, 3823, 3824, 3825, 3826, 3827, 3828, 3829, 3830, 3831, 3832, 3833, 3834, 3835, 3836, 3837, 3838, 3839, 3840, 3841, 3842, 3843, 3844, 3845, 3846, 3847, 3848, 3849, 3850, 3851, 3852, 3853, 3854, 3855, 3856, 3857, 3858, 3859, 3860, 3861, 3862, 3863, 3864, 3865, 3866, 3867, 3868, 3869, 3870, 3871, 3872, 3873, 3874, 3875, 3876, 3877, 3878, 3879, 3880, 3881, 3882, 3883, 3884, 3885, 3886, 3887, 3888, 3889, 3890, 3891, 3892, 3893, 3894, 3895, 3896, 3897, 3898, 3899, 3900, 3901,

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed and the case remanded for further proceedings."

Respectfully submitted.

ERWIN N. GRISWOLD,

Solicitor General.

LAWRENCE G. WALLACE,

Assistant to the Solicitor General.

PHILIP A. LOOMIS, JR.,

General Counsel,

DAVID FERRER,

Solicitor,

EDWARD B. WAGNER,

Assistant General Counsel,

FRANK N. FLEISCHER,

Attorney,

Securities and Exchange Commission.

JULY 1968.

"The district court held that the relief the Commission sought (see *supra*, pp. 6-7) was not authorized by the statute and would be inappropriate (App. 144). The court of appeals did not decide the question. If this Court reverses on the McCarran-Ferguson Act issue, it should remand for the court of appeals to consider the relief question and the other issues tendered by the parties that it did not decide. Cf. *Federal Trade Commission v. Borden Co.*, 383 U.S. 637, 639.

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APPENDIX

RELEVANT STATUTES AND RULE

The McCarran-Ferguson Act, 59 Stat. 33-34, as amended, 15 U.S.C. 1011-1015, provides in pertinent part:

§ 1. Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

§ 3. (a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Fed-

eral Trade Commission Act, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation.

§ 4. Nothing contained in this chapter shall be construed to affect in any manner the application to the business of insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920.

Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j, provides in pertinent part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors;

Rule 10b-5 under the Securities Exchange Act of 1934, 17 CFR 240.10b-5, provides:

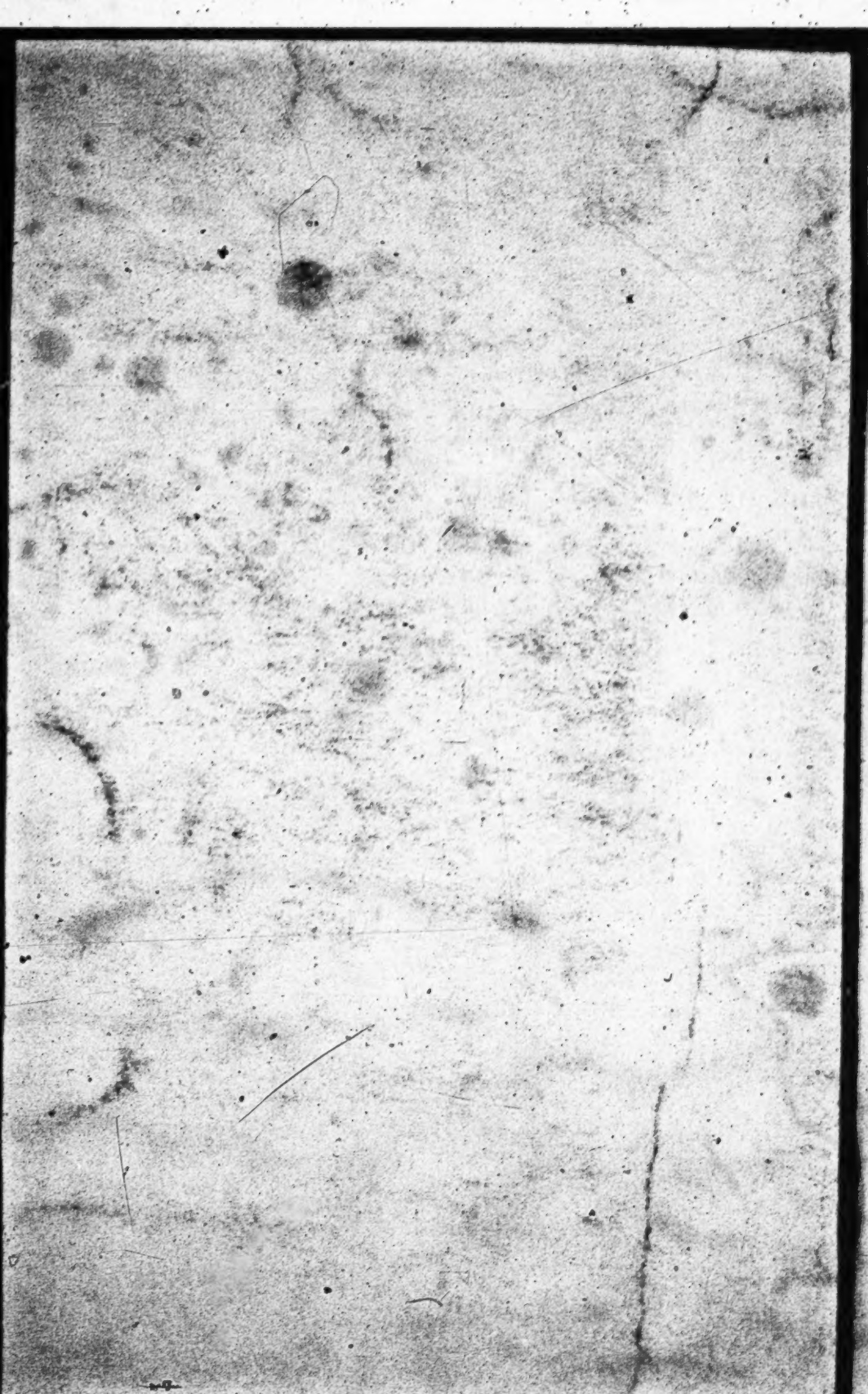
It shall be unlawful for any person, directly or indirectly, by the use of any means or in-

instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.



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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1968

No. 41

SECURITIES AND EXCHANGE COMMISSION,

Petitioner,

vs.

NATIONAL SECURITIES, INC., ET AL.,

Respondents.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE NINTH CIRCUIT**

BRIEF FOR NATIONAL SECURITIES, INC., ET AL.

LEWIS ROCA BEAUCHAMP & LINTON

**By John P. Frank
A. Gordon Olsen
114 West Adams
Phoenix, Arizona 85003**

INDEX

	<i>Page</i>
OPINIONS BELOW	1
QUESTION PRESENTED	2
STATUTES AND RULES INVOLVED	2
STATEMENT	2
A. The parties, Their Transaction, and the SEC Complaint	2
B. Proceedings Through Ex Parte Order	5
C. Proceedings from Application for Preliminary Injunction Through Merger	5
D. Proceedings from Merger Through the District Court Ruling	7
E. Proceedings in the Court of Appeals	8
SUMMARY OF ARGUMENT	9
ARGUMENT	11
I. Introduction	11
II. A Merger does not Involve a "Purchase" or "Sale" of Securities	13
A. This is a "No-Sale" Case	13
B. If the "No-Sale" Rule is to be Changed, it should be Prospective Only	20
III. The McCarran Act does Preclude the SEC's Attack upon this Merger of Two Arizona Insurance Companies	23
A. Introduction	23
B. The McCarran Act Bars Federal Supersession of State Insurance Laws	27
C. The Arizona Insurance Code Contains Direct Provisions Which are Impaired or Superseded by the SEC Action	29

INDEX—(Cont'd.)

	<i>Page</i>
IV. Proxy Solicitations for a Merger are not Covered by § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5	34
V. The Writ of Certiorari was Improvidently Granted..	37
CONCLUSION	38
APPENDIX A	39
McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. § 1011-13	39
Sec. 10(b), Securities and Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j	40
SEC Rule 10b-5, 17 C.F.R. 240.10b-5	40
Securities Acts Amendments of 1964, 78 Stat. 565-69, 15 U.S.C. §§ 781(g), 78n	41
SEC Rule 12h-1, 17 C.F.R. § 240.12h-1	43
SEC Rule 14a-9, 17 C.F.R. § 240.14a-9	43
Arizona Revised Statutes:	
(Merger Statutes) §§ 10-341, <i>et seq.</i>	44
§ 20-143. Rule-making power	47
§ 20-443. Misrepresentations and false advertising of policies	48
§ 20-444. False or deceptive advertising of insurance or status as insurer	48
§ 20-731. Merger or consolidation of stock insurers..	49
APPENDIX B	50
Excerpts from: SEC, Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, Part VII (1938).	

TABLE OF CASES AND AUTHORITIES CITED

Cases:	Page
<i>Allstate Ins. Co. v. Lanier</i> , 361 F.2d 870 (4th Cir. 1966)	28
<i>American Trucking Ass'n v. Atchison, T. & S.F. Ry. Co.</i> , 387 U.S. 397, 87 S. Ct. 1608, 18 L. Ed. 2d 847 (1967)	19, 20
<i>Barnett v. Anaconda Co.</i> , 238 F. Supp. 766 (S.D.N.Y. 1965)	36
<i>Blau v. Lehman</i> , 368 U.S. 403, 82 S. Ct. 451, 7 L. Ed. 2d 403 (1962)	20
<i>Borak v. J. I. Case Co.</i> , unreported in District Court, rev'd on other grounds, 317 F.2d 838 (7th Cir. 1963), aff'd, 377 U.S. 426, 84 S. Ct. 1555 (1964)	35
<i>California League of Independent Ins. Producers v. Aetna</i> <i>Casualty</i> , 175 F. Supp. 857 (N.D. Cal. 1959)	28
<i>Dasbo v. Susquehanna Corp.</i> , 380 F.2d 262 (7th Cir. 1967), cert. denied, 389 U.S. 977, 88 S. Ct. 480, 19 L. Ed. 2d 470 (1967)	9, 14, 19
<i>England v. Board of Medical Examiners</i> , 375 U.S. 411, 84 S. Ct. 461, 11 L. Ed. 2d 440 (1964)	21
<i>FTC v. Bunte Bros., Inc.</i> , 312 U.S. 349, 61 S. Ct. 580, 85 L. Ed. 881 (1941)	20
<i>FTC v. National Gas. Co.</i> , 357 U.S. 560, 78 S. Ct. 1260, 2 L. Ed. 2d 1540 (1958)	30
<i>FTC v. Travelers Health Ass'n</i> , 362 U.S. 293, 80 S. Ct. 717, 4 L. Ed. 2d 724 (1960)	30
<i>Gelpcke v. Dubuque</i> , 68 U.S. 175, 17 L. Ed. 520 (1864)	21
<i>Great N. Ry. v. Sunburst Oil & Ref. Co.</i> , 287 U.S. 358, 53 S. Ct. 145, 77 L. Ed. 360 (1932)	21

TABLE OF CASES AND AUTHORITIES CITED—(CONT'D.)

Cases:	Page
<i>Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co.</i> , 67 Civ. 4855, (S.D.N.Y., July 30, 1968)	33
<i>James v. United States</i> , 366 U.S. 213, 81 S. Ct. 1052, 6 L. Ed. 2d 246 (1961)	10, 21, 22
<i>Johnson v. New Jersey</i> , 384 U.S. 719, 86 S. Ct. 1772, 16 L. Ed. 2d 882 (1966)	21
<i>Linkletter v. Walker</i> , 381 U.S. 618, 85 S. Ct. 1731, 14 L. Ed. 2d 601 (1965)	10, 22
<i>Maryland Cas. Co. v. Cushing</i> , 347 U.S. 409, 74 S. Ct. 608, 98 L. Ed. 806 (1954)	23
<i>National Supply Co. v. Leland Stanford Junior Univ.</i> , 134 F.2d 689 (9th Cir. 1943), cert. denied, 329 U.S. 773, 64 S. Ct. 77, 88 L. Ed. 462 (1943)	9, 10, 14, 17, 18, 19, 21, 22
<i>North Little Rock Transp. Co. v. Cas. Reciprocal Exch.</i> , 181 F.2d 174 (8th Cir. 1950)	28
<i>Panama Ref. Co. v. Ryan</i> , 293 U.S. 388, 55 S. Ct. 241, 79 L. Ed. 446 (1935)	23
<i>Power Reactor Dev. Co. v. International Union</i> , 367 U.S. 396, 81 S. Ct. 1529, 6 L. Ed. 2d 924 (1961)	20
<i>Sanford's Estate v. Commissioner</i> , 308 U.S. 39, 60 S. Ct. 51, 84 L. Ed. 20 (1939)	20
<i>SEC v. United Benefits Life Ins. Co.</i> , 387 U.S. 202, 87 S. Ct. 1557, 18 L. Ed. 673 (1967)	11, 28, 29
<i>SEC v. Variable Annuity Life Ins. Co.</i> , 359 U.S. 65, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959)	10, 11, 27, 28, 29
<i>Transnational Ins. Co. v. Rosenlund</i> , 261 F. Supp. — 12 (D. Ore. 1966)	28

TABLE OF CASES AND AUTHORITIES CITED—(CONT'D.)

Cases:	Page
<i>United States v. Philadelphia Nat'l Bank</i> , 374 U.S. 321, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963)	20
<i>United States v. Sylvanus</i> , 192 F.2d 97 (7th Cir. 1961)	30
<i>Vermilya-Brown Co. v. Connell</i> , 335 U.S. 377, 69 S. Ct. 140, 93 L. Ed. 76 (1948)	19
<i>Vine v. Beneficial Finance Co.</i> , 374 F.2d 627 (2d Cir. 1967), cert. denied, 389 U.S. 970, 88 S. Ct. 463, 19 L. Ed. 2d 460 (1967)	14
<i>Statutes and Rules:</i>	
Arizona Insurance Department, Rule No. 66-12	35
<i>Arizona Revised Statutes:</i>	
§ 10-341 to -49	16
§ 10-344	16
§ 20-143	35
§ 20-443(3)	32
§ 20-444A	32
§ 20-615(4)	24
§ 20-731	10, 29, 31, 34
Fed. R. Civ. P. 62(c)	21
<i>McCarran-Ferguson Act</i> , 59 Stat.	
33-34, 15 U.S.C. 1011-1015	2, 8, 9, 10, 11, 12, 13, 23, 24, 26, 27, 28, 32, 37, 38
<i>Securities Act of 1933</i> , 48 Stat. 74,	
15 U.S.C. 77a, et seq.	
§ 17, 15 U.S.C. § 77q	15

TABLE OF CASES AND AUTHORITIES CITED—(CONT'D.)

Cases:	Page
§ 5, 15 U.S.C. § 77f	15
Rule 133, 17 C.F.R. 230.133	15, 22
Securities Act Amendments of 1964, 78 Stat. 565	2, 34, 36, 37
Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. § 78a, <i>et seq.</i>	
§ 10(b)	2, 7, 8, 9, 11, 12, 13, 15, 18, 34, 35, 36, 37, 38
§ 14	7, 34, 35, 37
§ 12	34
Rule 10b-5, 17 C.F.R. 240.10b-5	2, 7, 34
SEC Regulation 12h-1, 17 C.F.R. 240.12h-1	34
28 U.S.C. § 1254(1)	2
28 U.S.C. § 1292(a) (1)	21
Miscellaneous:	
91 Cong. Rec. 479 (1945)	28
91 Cong. Rec. 1444 (1945)	30
Federal Securities Law Reports, CCH, No. 905, pt. 1, June 20, 1963	36
2 CCH Fed. Sec. L. Rep., para. 23, 310	35
F. Frankfurter & H. Shulman, <i>Cases and Other Authorities On Federal Jurisdiction and Procedure</i> (rev. ed. 1937)	31
Hearings on H.R. 4344, H.R. 5065, and H.R. 5832 Before the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., pt. III (1941)	18, 19, 37

TABLE OF CASES AND AUTHORITIES CITED—(CONT'D.)

	<i>Page</i>
Hearings on the Insurance Industry Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 86th Cong., 1st Sess., pt. 2.	24, 25
House Doc. No. 95, pt. 3, 88th Cong., 1st Sess.	36
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A. Milton, <i>Life Insurance Stocks: An Investment Appraisal</i> (1965)	30
1B J. Moore, <i>Federal Practice</i> (2d ed. 1965)	21
Note, <i>Prospective Overruling and Retroactive Application in the Federal Courts</i> , 71 <i>Yale L. J.</i> 907 (1962)	22
Securities Act Releases	
No. 3420 (1951)	22
No. 3965 (1958)	22
No. 4115 (1959)	22
Senate Comm. on Judiciary, Insurance: Aviation, Ocean Marine, and State Regulation, S. Rep. No. 1834, 86th Cong., 2d Sess. (1960)	26
S. Doc. No. 35, 77th Cong., 1st Sess. 596 (1941)	28
R. Stern & E. Gressman, <i>Supreme Court Practice</i> (3d ed. 1962)	38

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OF APPEALS FOR THE NINTH CIRCUIT**

BRIEF FOR NATIONAL SECURITIES, INC., ET AL.

Opinions Below

The opinion of the District Court (App. 139-44) is reported at 252 F. Supp. 623. The opinion of the Court of Appeals (App. 148-61) is reported at 387 F.2d 25.

The judgment of the Court of Appeals was entered on November 14, 1967 (App. 162). The petition for certiorari, filed on

March 4, 1968, within time duly extended by Justice Douglas on February 10, 1968, was granted on April 22, 1968 (App. 163). This Court has jurisdiction under 28 U.S.C. § 1254(1).

Question Presented

We cannot agree that the "question presented" as offered by the Government is the question actually presented to and decided by the court below. We therefore restate the question as follows:

Whether § 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 issued thereunder, read in the light of the McCarran-Ferguson Act, apply to allegedly false and misleading statements made in soliciting stockholder consents to a merger of insurance companies where the same matters, under applicable State statutes, have been before the Arizona State Director of Insurance who has approved the merger.

Statutes And Rules Involved

The relevant provisions of the McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. §§ 1011-1015; § 10(b) of the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. § 78j(b), and Rule 10b-5 of the General Rules and Regulations under the Securities Exchange Act of 1934, 17 C.F.R. 240.10b-5; the relevant provisions of the Securities Acts Amendments of 1964, 78 Stat. 565, 15 U.S.C. § 78l(g), and 78 Stat. 569, 15 U.S.C. § 78n (1964); and of the several applicable provisions of the statutes of Arizona are set forth in Appendix A. to this brief.

Statement

A. The Parties, Their Transaction, and the SEC Complaint.

This case involves National Producers Life Insurance Company (National Producers), which is in fact one of the largest life insurance companies incorporated in Arizona. The company is the product of a merger which occurred in 1965, and it is that merger which gives rise to this action. In April, 1964, National Securities, Inc. (National Securities) held a controlling interest

in an Arizona insurance company, National Life and Casualty Company (National Life). National Securities bought a substantial block of stock in a second Arizona insurance company, Producers Life Insurance Company (Producers). The stock of National Life and the stock of Producers were traded over-the-counter and neither was registered on any national securities exchange.

The details of the purchase agreement are immaterial here. Since the case was decided on a motion for judgment on the pleadings, we merely note that the pleadings are in conflict. The SEC claims that National Securities bought stock from a group of principal shareholders of Producers, and that it did so contemplating a consolidation of National Life and of Producers. It alleges that the selling parties undertook not to compete with Producers or any resultant company, and that this obligation was later put upon the consolidated company; which, by paying for the non-compete agreements, would thus be paying a portion of the cost of acquiring the interest in Producers.

While the complaint uses strong conclusory language, reflected in the Government's brief here, pp. 3 and 4, with its talk of "an illegal scheme" and violation of "the antifraud provisions of the Act," we have not understood the Commission, in this Court at least, to have any complaint of the *terms* of the agreement by which National Securities purchased the Producers stock. That is to say, there is no contention here that the price was unfair or the terms were somehow illegal or inequitable. Obviously, any purchase in which there are to be continuing payments involving a possible later merger or consolidation will commonly involve the utilization of funds of the company being acquired. The contention of the Commission is, rather, that there were inadequate disclosures in the proxy solicitation attendant upon the later merger; for subsequent to the 1964 purchase, there was

a merger of the two insurance companies.¹ A vigorous proxy fight occurred over the merger; there was a hard-hitting proxy solicitation campaign on both sides; see e.g. App. 46, 60, 117, *et seq.*

As synopsised in its brief here, the Complaint of the Commission, duly challenged in the Answer, was that the defendants, in soliciting support for the merger, either misinformed or inadequately informed the Producers shareholders in four respects:

1. The SEC alleges that the proxy solicitation made clear to the voters that the non-compete agreements would be assumed by the surviving corporation but did not disclose the dollar amount of this assumption (Amended Complaint, paras. 22-23, App. 90-91; Answer, paras. 22-23, App. 105).

2. The SEC alleges that the company forecast a net income of the reorganized company, before taxes, of \$460,000 for the year 1965, which is said to be *per se* misleading and to fail to disclose past losses (Amended Complaint, paras. 28, 33, App. 94-95; Answer, App. 105, 106.)²

3. The SEC alleges that the company included in its *pro forma* balance sheet an asset said to be "illusory" (Amended Complaint, para. 27, App. 93-94). The company answers that the particular figure in controversy had been "authorized expressly by the Insurance Commissioner of Arizona in writing for this general purpose," and that the use made was "permissible

¹ This was not the transaction which was contemplated in April, 1964, when the non-compete agreements were made. Originally, National Securities agreed to manage Producers at a guaranteed profit (App. 33); so that Producers would become a majority-owned subsidiary, it was then contemplated that Producers shareholders would acquire National Securities stock (App. 27-30). But, due to stockholder dissatisfaction, the management agreement was cancelled; for reference by way of allusion, see R. 126. The merger proposal for National Life and Producers then originated, with provisions giving the merged company responsibility on the non-compete agreements. National Securities owned about 36 percent of the surviving corporation (R. 718).

² Certainly much loss record information was given the shareholders; see App. 34, 64.

under generally accepted accounting practices" (Answer, para. 27, App. 105).

4. The SEC alleges that the literature mailed did not disclose that certain shares of Producers had been written down on the books of National Life to a given figure (Amended Complaint, para. 33(b), App. 95-96). The answer claims that the usage was proper (Answer, para. 33, App. 106).

B. Proceedings Through Ex Parte Order.

The purchase of the Producers Life shares occurred on April 27, 1964. On November 27, 1964, the Board of Directors of National Life and Producers agreed to merge (App. 18). Producers shareholders were soon to vote on the proposed merger, when on May 30 the Commission filed its complaint for an injunction (App. 11) and its application for a temporary restraining order, which was granted *ex parte* (App. 55).

The restraining order contained a paragraph of boiler plate—the defendants were enjoined from using interstate commerce or the mails "to engage in any manipulative or deceptive device or contrivance." There then followed four specific prohibitions, the practical effect of which restrained defendants from going forward with the merger (App. 56-58), voting any proxies which had been obtained for the merger, or "performing any act which facilitates or is designed to facilitate the consummation of" the merger (App. 57-58).

In short, the operative portions of the order enjoined the merger and any steps leading to it.

C. Proceedings from Application for Preliminary Injunction Through Merger.

The National Securities group of defendants answered, denying jurisdiction in the court, alleging that the complaint failed to state a claim upon which relief could be granted, and generally pleading to the complaint (App. 65). The Commission applied for a preliminary injunction (App. 25), and the defendants moved for judgment of dismissal and also for denial of the preliminary injunction (App. 4).

The matter came on for hearing on April 16, 1965 (Mathes, J.), the court concluding (App. 72-75) that the question of merger or no merger was essentially one for the State to decide. As had been fully developed before the court, any merger, if approved by the shareholders, must be presented to the State Insurance Department. The parties therefore stipulated in open court that if the meeting were held, and if the stockholders approved the merger, the SEC would be given a week's notice before the matter was submitted to the Insurance Director so that the Commission might take any action it desired.

As the court put it to the company, "You can hold your meeting, you can vote your proxies, you can submit it to the Insurance Commissioner or Director of Insurance." Undersigned counsel assured the SEC that it would have a week's telegraphic notice before submission, a time period accepted as "entirely satisfactory" to the Commission (App. 74). The Judge did not pass in any way on the validity of the proxies or the procedures in connection with the merger, simply leaving the whole matter to the Insurance Director (App. 75). On this basis, the court struck from the restraining order all except the boiler plate portion, eliminating every restraint upon the merger (App. 77-78).

There thus being no legal impediment, the shareholders overwhelmingly approved the merger (R. 437-38). The Commission was duly advised. It did not move for any stay of the cancellation of the operative portions of the temporary restraining order, nor did it apply to any higher court for relief. Instead, on April 28, the Commission wrote the Arizona Director of Insurance stating its view of the illegality of the proxy solicitation and forwarding to the Arizona Director all of the pleadings and evidentiary materials which had been before the Federal District Court (R. 390-97).

Under Arizona law, as will be more fully particularized, a merger of insurance companies can occur only upon approval by the Arizona Director of Insurance, who is expressly required to

consider stockholder as well as policyholder interests. Having had the opportunity to consider any matters which might have been presented by any objecting persons, and to consider the full record which was submitted by the SEC, the Arizona Director of Insurance approved the merger (R. 800), and the surviving insurance company has since functioned as National Producers Life Insurance Company (National Producers).³

D. Proceedings from Merger Through the District Court Ruling.

In August, 1965, a month after the merger (App. 8), the Commission filed its amended and supplemental complaint for injunction. The essence of the prayer for relief (App. 98-100) was that the parties should be required to undo the merger, restoring the companies and their stockholders to their pre-merger condition. The defendants responded with an answer (App. 101) and with a motion for judgment on the pleadings or in the alternative for summary judgment (App. 109).

On February 7, 1966, the trial court granted the motion for judgment on the pleadings (App. 139). The order of the district court noted and decided these points:

1. The charge was illegal solicitation of proxies in connection with a merger (para. 2, App. 140). To this end, the court in effect was asked to undo the merger.

2. The case was brought under § 10(b) of the Securities Exchange Act of 1934, and its concomitant Rule 10b-5. The acts complained of would fall within the prohibitions of the proxy-solicitation provisions and the antifraud provisions of a different section of that Act, § 14, but for two circumstances: first, § 14 did not, at the time of the transaction, apply to the company; its broadened coverage was not effective until 1966. Second, even in 1966, the section would apply only if insurance companies

³ As of 1968, there have been some ownership and structural changes which are outside the record. We therefore note merely that the statements relating to the insurance company and its parent are accurate as of the date of the closing of the record.

were not exempt under still another section which conditionally excluded insurance company securities (paras. 4-5-6, App. 141).

3. There were two subsidiary issues: first, a question as to whether § 10(b) applied to proxy solicitations at all; and second, a separate issue as to whether a statutory merger is a "purchase or sale" of securities within the meaning of § 10(b) of the Act. The district court expressed doubt as to coverage on both grounds, but did not rest its decision on either (para. 7, App. 141).

4. The district court thus came to its main ground of decision. It noted that under the McCarran Act, no Act of Congress should be construed "to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance." It found that the law of Arizona did expressly provide that authority over insurance company mergers was given to the Director of Insurance who was required to consider, among other things, whether the plan was legal, fair to stockholders, or injurious to policyholders, and that under Arizona law there was adequate procedure for appeal from any decision of the Director on the merger issue (paras. 9, 10, 11, App. 142-43). It concluded that to invalidate the merger which had been approved by the Arizona Director of Insurance "would at least 'impair,' if not 'invalidate' or 'supersede,' laws enacted by the State of Arizona" for the regulation of insurance (para. 12, App. 143).⁴

E. Proceedings in the Court of Appeals.

The Court of Appeals affirmed (App. 148-61). It too treated the case as an effort by the Commission "to undo the merger of two stock life insurance companies" because of the proxy solicitation. The Court put aside as unnecessary for decision the question of whether there was an absence of indispensable parties; the

⁴ The district court also found (para. 13, App. 143-44) that nullification of the merger was beyond the court's power under this section of the Act, a decision appealed by the SEC but not decided by the Court of Appeals.

question of whether there was a "purchase or sale"; and the question of whether the statute permitted the relief requested (App. 154). It noted that Arizona had "accepted the invitation of the McCarran Act" (App. 157) to make its own regulation of insurance and that it had "affirmatively asserted its power to regulate the merger of insurance companies." (App. 159) It held that the effort by the SEC to invalidate the merger conflicted with the McCarran Act.

This petition duly followed.

Summary Of Argument

The parties see this case very differently. For the Commission, the issue is whether the McCarran Act immunizes transactions in securities of insurance companies from the application of the federal securities laws. But the company, which without any question submits to Commission jurisdiction in many securities matters, has never put this question in issue. Neither the District Court nor the Court of Appeals ever decided anything of the sort.

The McCarran Act question which does come here from the Court of Appeals is whether § 10(b) of the Securities Exchange Act of 1934 permits nullification of an insurance company merger for false and misleading proxy solicitations when the State Insurance Department under a State statute governing mergers has approved the merger after consideration of the identical materials which the SEC tendered both to it and to the District Court.

There are preliminary questions. Section 10(b) applies only to a "purchase or sale" of a security. In connection with a statutory merger, there is not in the obvious sense at least, any purchase or any sale; there is simply a conversion of stock. There is a direct conflict of Circuits on the point; see *National Supply Co. v. Leland Stanford Junior Univ.*, 134 F. 2d 689 (9th Cir. 1943), *cert. denied*, 320 U.S. 773, 64 S. Ct. 77, 88 L. Ed. 462 (1943), and *Dasbo v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 389 U.S. 977, 88 S. Ct. 480, 19 L. Ed. 2d 470 (1967). The Commission itself has been on both sides of the

question, Justices Douglas and Fortas in their Commission days being connected with the position that there was "no sale" in these circumstances and the Commission now saying the opposite. We contend that there is no sale and rely heavily on the argument put forth by the Commission itself in the *National Supply Co.* case. The Commission squarely and specifically presented to Congress the question of whether this rule should be changed, and Congress has never seen fit to do so. If the rule is, however, now to be changed without benefit of the Act of Congress which the Commission once thought necessary, then we ask that the interpretation be prospective only; see *James v. United States*, 366 U.S. 213, 81 S. Ct. 1052, 6 L. Ed. 2d 246 (1961) and *Linkletter v. Walker*, 381 U.S. 618, 85 S. Ct. 1731, 14 L. Ed. 2d 601 (1965).

The McCarran Act does preclude the SEC's attack upon the merger of two Arizona insurance companies. The statute provides that no Act of Congress may "invalidate, impair, or supersede" a state law regulating the business of insurance. Here, directly on point in the heart of the Arizona Insurance Code, is a direct regulation of mergers, direct control of allegedly misleading statements, direct provision for the protection of investors as well as policyholders; see A.R.S. § 20-731 and other sections. We are hard put to imagine how the federal government could more totally impair or supersede a state regulation than to make a direct reversal of the State Insurance Department.

While the Commission seeks to construe the McCarran Act more narrowly than we believe does this Court, *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 79 S. Ct. 618, 3 L. Ed. 2d 540 (1959), even the SEC acknowledges that such historical matters as "the chartering and licensing of insurance companies" are within state power. The approval of this merger by the Insurance Department is merely a functional variant of chartering and licensing; by his approval, the Insurance Director permits the company to exist in its merged form. In repeated instances, Congress

has been assured that insurance mergers were state business unless the McCarran Act should be amended, as it has not been. Such decisions as *SEC v. Variable Annuity Life Ins. Co.*, *supra* and *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 87 S. Ct. 1557, 18 L. Ed. 673 (1967), on which the Commission relies, deal with activities by insurance companies which are not insurance at all, and where the companies are not "primarily engaged in the insurance business," SEC Br., *Variable Annuity*, *supra*, 55. In this instance, the issue is whether an insurance company shall be allowed to exist, and the company has no other activities of any kind except the most classic insurance business.

The fundamental question in this case is which court and administrative system in the United States has jurisdiction to decide whether these companies may merge. By virtue of the McCarran Act plus the complete and responsible assumption of power by the State, this is a State question.

Proxy solicitations for a merger are in any case not covered by § 10(b) of the Securities Act of 1934. Jurisdiction for this purpose was extended to the SEC only by virtue of an amendment to the law which did not take effect until after the events here involved, an amendment which was presented by the SEC to Congress on the express ground, among others, that it was needed in connection with proxy solicitations for mergers. We ask the Commission to tell us why the Commission told Congress that it needed to amend the Act to make the proxy rules applicable to mergers of over-the-counter companies without telling Congress, as it now contends, that it already had that power under an existing section of the 1934 Act.

Argument

I. Introduction.

This is one of those cases which is settled once the Court decides what it is about; the real battle is over definition of the issue. The Government states the question as whether the McCarran Act "precludes the application of the antifraud provisions of the

Securities Exchange Act of 1934 to false and misleading statements made in soliciting stockholder consents to a merger of insurance companies"; but its argument moves far indeed from this statement. The Summary of Argument at pages 8-10 does not even mention the word merger or consolidation or anything else relating to that subject matter. Rather, it confines itself to an argument aimed at "the applicability of the federal securities laws to transactions in insurance company securities." The essential argument of the Government, which occupies substantially all of its brief (pp. 10-28), is that "The McCarran-Ferguson Act does not immunize transactions in securities of insurance companies from the application of the federal securities laws." (SEC Br. 10)

The Government battles a straw man. No one contends that there is some general immunization of all securities of insurance companies from SEC regulation. Indeed, the very companies here principally involved, National Life and Producers, have filed registration statements or related documents with the SEC; see SEC Br., p. 16, n. 12. We have no doubt whatsoever that at least some SEC regulations apply to at least some insurance company securities in at least some states—doubtless many regulations apply in all of them.

It does serious injustice to the earnest efforts of the lower courts for the Government to present this case as if those courts had held that the Act does immunize transactions in securities of insurance companies from the application of federal securities laws. The district court found doubtful whether § 10(b) of the Securities Act of 1934 applies at all to proxy solicitations, but this gives no immunity, since a subsequent amendment now applies. The district court held that the State of Arizona has an express code regulating the merger of insurance companies which is broad enough to permit the Director of Insurance to consider, from every angle, all of the abuses which the Commission alleges occurred, and that there is adequate opportunity for judicial review in the State system. It thereupon found that to set aside the merger

would impair laws enacted by the State of Arizona for the purpose of regulating the business of insurance. In the four pages of findings by the District Court (App. 139-44), there is not a syllable open to the construction that insurance company securities generally are beyond the reach of the Commission.

The Court of Appeals with care stated what it regarded to be the only issue which it was deciding: "Whether the allegations of the amended and supplemental complaint, which allegations must be presumed by us to be true, warrant the invalidation of the merger in light of the provisions of the McCarran Act." The Court then sketched the background of the McCarran Act and noted that it contained an invitation to the states to deal affirmatively and effectively with insurance industry problems. The Court noted that "the State of Arizona accepted the invitation of the McCarran Act." And how did the State of Arizona accept this invitation? By certain specific statutes relating to trade practices; and the State also has (whether in response to the "invitation" or not) detailed regulations of mergers. Hence, the Court found that "the State of Arizona has affirmatively asserted its power to regulate the merger of insurance companies."

We believe that we have accurately stated the question presented: Does § 10(b) of the Act and its concomitant rule, read in the light of the McCarran-Ferguson Act, apply to allegedly false and misleading statements made in soliciting stockholder consents to a merger of insurance companies where the same matters, under applicable state statutes, have been before the Arizona State Director of Insurance who has approved the merger?

II. *A Merger does not Involve a "Purchase" or "Sale" of Securities.*

A. *This is a "No-Sale" Case.*

This action was originally brought under § 10(b) of the Securities Act of 1934. This section prohibits certain conduct "in connection with the purchase or sale of any security." If, therefore, a statutory merger is not a "purchase or sale," then we never reach the other questions of the case.

There is a direct conflict of Circuits on this point. The Seventh Circuit has held that a merger is a purchase or sale, *Dasbo v. Susquehanna Corp.*, 380 F.2d 262 (7th Cir. 1967), *cert. denied*, 389 U.S. 977, 88 S. Ct. 480, 19 L. Ed.2d 470 (1967). As the SEC acknowledges at p. 11, n. 6 of its brief, the Ninth Circuit stated the contrary in *National Supply Co. v. Leland Stanford Junior Univ.*, 134 F.2d 689 (9th Cir. 1943), *cert. denied*, 320 U.S. 773, 64 S. Ct. 77, 88 L. Ed. 462 (1943).⁵ As the instant case came to the Ninth Circuit, this was the big question in it; the Commission asked for an extension of time to brief the matter on the ground of the importance of the case because it wanted the Ninth Circuit to "overrule or severely delimit a determination previously made by it" in the *National Supply Co.* case.⁶

The Commission says in its brief here, "For many years the Commission has regarded an exchange of securities" as a "purchase" or a "sale" within the scope of this Act; SEC Br., p. 11. But it was not ever so. When Mr. Justice Douglas was chairman of the Commission and Mr. Justice Fortas was a member of its staff, the Commission took the opposite view. The Ninth Circuit *National Supply Co.* opinion was based on the then stand of the Commission that a consolidation did not involve a sale, and this in turn was based upon a report transmitted over the signature of Mr. Justice Douglas, based on staff work by, among others, the present Justice Fortas; for details, see the Report, the relevant portions of which we have placed in Appendix B to

⁵ The Government also claims in the same note that the Second Circuit has agreed with the Seventh in *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir. 1967), *cert. denied*, 389 U.S. 970, 88 S. Ct. 463, 19 L. Ed. 2d 460 (1967). The *Vine* case, which involved a compulsory exchange of stock for money, we think distinguishable, as it expressly asserts itself to be: "It is precisely because appellee gives no choice to Vine under the statute and the latter must now exchange his shares for cash that appellee can now be deemed a seller." 374 F.2d at 635.

⁶ See affidavit of Newman in support of motion of the Commission for enlargement of time, Dec. 29, 1966.

this brief.⁷ The earlier Commission report stated that in the case of a "typical consolidation, merger, or sale of assets," the essential element of a sale was absent.

We of course savor the fact that then, at least, such high authority seems to have shared our view of the matter; for we do contend that a merger is not a sale at all. We are dealing with what is called the "no-sale doctrine" and the interpretation of the 1934 Act in this respect begins with the 1933 Act. Section 17 of the 1933 Act, 15 U.S.C. § 77g, in various ways is directed at frauds in the sale of securities. The term "sale" is used also in Section 5 of the 1933 Act, 15 U.S.C. § 77f, and in turn is defined in Commission Rule 133, 17 C.F.R. 230.133. It is thus Rule 133 and its antecedents which is the origin of the "no sale doctrine."

Rule 133 expressly excludes from the definition of "sale" a transaction (a) where, in accordance with state law, a plan or agreement for a statutory merger or consolidation is submitted to the vote of the stockholders; (b) where such a merger can be adopted only upon the vote of some established majority of the outstanding stock; and (c) where such a vote is binding on all stockholders except to the extent that dissenters may be entitled to receive the appraised or fair value of their holdings. Rule 133 could not cover more precisely an Arizona statutory merger—every item in the rule is also in the Code.

It follows that if the no-sale doctrine embodied in Rule 133 as applied to the 1933 Act is equally applicable to § 10 of the 1934 Act, then there could not conceivably be jurisdiction in the instant case because there is no "sale."

We begin with precisely what it was that the parties were

⁷ This was a large work, and we do not mean to suggest that we can tell from the Report whether either of the Justices was individually, as distinguished from institutionally, responsible for this detail. As noted above, the relevant language is in the Appendix. See SEC, Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, pt. VII, p. 249, n. 172 (1938).

doing. The consolidation or merger plan presented for the vote for which proxies were solicited (App. 41-42) provided that "The principal purpose of this Agreement is to provide for the merger of National Life into Producers, which will continue as the surviving corporation, governed by the laws of the State of Arizona." The parties agreed to submit their plan to the Director of Insurance and to the stockholders (R. 80).

For the actual stock conversion, Paragraph 12 of the Agreement covers the "manner of converting the shares and assets of National Life." Producers was to "issue and deliver to the stockholders of National Life" a share of Producers stock for each share of National Life stock. If a National Life stockholder for whatever reason simply kept his National Life stock, the same paragraph provided that he should be regarded "for all corporate and legal purposes, to be the owner of that number of National Producers shares." (App. 45.)

That is it. Prior to the merger, each shareholder had a certain number of shares of stock of Producers and after it, he had the equivalent in shares of National Producers. Before the merger, each shareholder of National Life had National Life shares, and after the merger, he had the same number of National Producers Life shares, with a minor adjustment to avoid fractions, Para. 16 of the Consolidation Agreement (R. 79 at 82).

The plan and the actuality were closely guided by the Arizona Code. A.R.S. § 10-341-49 covers mergers. Two corporations "may be consolidated"; they do so by making an agreement which covers how to convert the shares and assets of the retiring corporation. Notices are required and then "the agreement of the Boards of Directors to consolidate" is submitted to the shareholders. The vote, for which solicitation of proxies is expressly authorized, A.R.S. § 10-344, is whether to adopt or reject the consolidation plan. A non-insurance merger is legally effective upon the ratification of the agreement by each of the corporations, and there is no requirement that the shares even

be turned in or replaced. Dissenting stockholders may elect to be paid in cash for their shares. The Insurance Code adds to these requirements the approval by the Director of Insurance.

The transaction is a straight conversion, with no purchase or sale about it. A consolidation agreement either is or is not approved by the shareholders. If it is approved, then the National Life shareholders may, if they wish, turn in their old certificates and get new certificates, but no one buys, no one sells. If they do not wish to turn the old certificates in, they need not do so—the operative legal effect is all the same by virtue of simple conversion occurring from the act of approval of the agreement itself. The shareholder has the option, if he wishes, of getting a new certificate to represent the stock he actually holds. Any shareholder at any given point has two separable interests, the one his actual interest or ownership of his fraction of the corporation, and the other his piece of paper which is evidence of that ownership. The shareholder's actual interest is changed by the vote on the consolidation agreement and the resultant filings and approvals, and this without the faintest semblance of anyone selling or purchasing anything. All that happens thereafter is the exchange of pieces of paper recognizing this interest.

In the *National Supply Co.* case in the Ninth Circuit, the SEC filed a brief which was deposited with the District Court Clerk in the instant case. It contained the following language:

"But consolidations such as the one involved in this case and mergers under related provisions of law are not comparable to the various exchange situations just discussed. In such consolidations and mergers the alteration of the stockholder's security occurs not because he consents to an exchange, but because the corporation by authorized corporate action converts his security from one form to another. That is to say (as indicated by the Note to Rule 5), there is no sale where (1) the vote of the stockholders is effective (subject to directors' action and other statutory requirements) as corporate action and (2) this action binds all stockholders, assenters, dissenters, and non-voters alike (subject only to appraisal

rights of dissenters). The essence of the Commission's construction, as expressed in the Note, is that in such cases a proposed corporate act is submitted to stockholders to be accepted or rejected by them as a class, in their capacity as members of the corporate body. . . .

"A few examples will illustrate the difference between submission of a proposal for corporate action and an offer of exchange to stockholders as individuals:

"(1) A proposal for merger or consolidation is submitted to the vote of the directors of a corporation before being submitted to the stockholders. Although the merger or consolidation, if consummated, will result in the directors getting different securities for those they held before the vote, we think it obvious that the submission of the proposal to them is not a sale, because they act in their capacities as functionaries of the corporation, not as security holders. The fact that they may hold securities which will be changed by the corporate action is immaterial, since the submission to them is not for the purpose of choice as individuals but as a step in the process of corporate action. We believe that subsequent submission of the same plan to those same directors as stockholders no more involves a sale than does the submission to them as directors. Both directors' vote and stockholders' vote are necessary parts of the process of corporate action."

For reasons so well set forth by the SEC in the earlier case, we respectfully submit that there is no sale here on which § 10(b) can operate. Moreover, the SEC told Congress the same thing, and directly put up to Congress the question of whether to amend the Act. In 1941, in hearings on proposed changes in the Acts of 1933 and 1934, SEC Commissioner Purcell expressly directed the attention of the committee to "item 9 of the agenda, concerning the issue of securities in mergers, consolidations, and reorganizations."

Commissioner Purcell thereupon presented a comprehensive analytical statement with direct reference to the *National Supply* case which was then pending. He said:

"The Commission has reached the conclusion that the act was not intended to apply where (1) the vote of the stock-

holders is effective (subject to directors' action and other statutory requirements) as corporate action, and (2) this action binds all stockholders, assenters, dissenters, and nonvoters alike, subject only to appraisal rights of dissenters.⁸

This is precisely the instant situation. On the other hand, the Commissioner said, just as the SEC says today, that there is a possibility of some injury to the general public from inadequate control of mergers. Since "The Commission has interpreted the act as not applying," he said, and since the matter was pending in *National Supply*, "this committee may well wish to consider this problem, since if the interpretation is upheld Congress may desire to amend the act in order to bring these transactions within its registration provision."⁹

Congress has never seen fit to adopt the implied suggestion of the Commission that the Act be amended to apply to a situation such as the present. We cannot share the view that the Commission misinformed the Ninth Circuit Court of Appeals in 1943 and the Congress in 1941. We think that until Congress changes the statute, the Commission does lack the power it said it lacked. We appreciate that advocacy of legislation by an agency may be an unreliable guide as to the existing state of its powers, *American Trucking Ass'n v. Atchison, T. & S.N. Ry. Co.*, 387 U.S. 397,

⁸ In *Dasbo*, *supra*, the Seventh Circuit in coming to a different result, says (380 F.2d at 269): "This view does no violence to the statutory language, and is the present interpretation of the body which is responsible for the administration of the acts." This is true, but if we may respectfully say so, irrelevant. The law, particularly of commercial transactions, cannot change every time the SEC switches to a new and plausible alternative. The object of interpretation is to achieve the intent of the legislature, *Vermilya-Brown Co. v. Connell*, 335 U.S. 377, 69 S. Ct. 140, 93 L. Ed. 76 (1948), and countless other cases. This is a goal often difficult or obscure and sometimes nonexistent; but the mere fact that a given construction is plausible and that the SEC now sees the matter differently than it did earlier is not even constructive evidence of 1934 intent.

⁹ Hearings on H.R. 4344, H.R. 5065, and H.R. 5832 Before the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., pt. III, at 842, 845 (1941). The Investment Bankers Association, the National Association of Security Dealers, the New York Curb Exchange, the New York Stock Exchange, and the National Association of Manufacturers, in a joint statement, *id.* at 846-50, opposed extending the Act to mergers.

418, 87 S. Ct. 1608, 18 L. Ed. 2d 847 (1967), and that interpretation may not be foreclosed because of subsequent views concerning its scope, *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 348-49, 83 S. Ct. 1715, 10 L. Ed. 2d 915 (1963); but at the same time, an unsuccessful effort to get broader authority from Congress is at least some indication that a power does not exist, *FTC v. Bunis Bros., Inc.*, 312 U.S. 349, 352, 61 S. Ct. 580, 85 L. Ed. 881 (1941). This is particularly persuasive where the effort is combined, as here, with early administrative interpretation by those charged with the application of an act when it is untried and new, *Power Reactor Dev. Co. v. International Union*, 367 U.S. 396, 81 S. Ct. 1529, 6 L. Ed. 2d 924 (1961), and administrative practice is of special weight where, as here, reliance is placed on it, *Sanford's Estate v. Commissioner*, 308 U.S. 39, 60 S. Ct. 51, 84 L. Ed. 20 (1939). There is a suggestive analogy in *Blau v. Lehman*, 368 U.S. 403, 82 S. Ct. 451, 7 L. Ed. 2d 403 (1962), which also involved interpretation of the Securities Exchange Act of 1934. Language which would result in the interpretation which the SEC desired in *Blau* had been presented to Congress and not adopted; there, too, Congress left in effect an outstanding Court of Appeals decision. There, too, for a long time, the Commission at least acquiesced in that result. There, too, the Court of Appeals had relied on a then outstanding Commission interpretation. There, too, the SEC had strong policy arguments for the interpretation which it later desired. In the circumstances, this Court said:

"Congress can and might amend § 16(b) if the Commission would present to it the policy arguments it has presented to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made." 368 U.S. at 413.

B. If the "No-Sale" Rule is to be Changed, it should be Prospective Only.

In 1964, Producers had a practical decision to make. Should it guide its proxy materials by detailed and precise SEC standards,

or should it rely on the existing Ninth Circuit decision in *National Supply*, based on the SEC brief, that the merger was not a sale? If so, it would move through the state channels and rely on its conception of state standards.

We submit that it would be the most severe and unwarranted injustice to apply a reinterpretation of the no sale rule retroactively to this transaction. We are talking about undoing a merger, now well established, of two considerable insurance companies. There is no suggestion of any significant injustice to anyone in the Government's brief, and there is obvious injustice to all subsequent investors in unsettling the transaction. The Government did not ask for a stay or reinterpretation of the *National Supply* rule before the merger, when there was abundant opportunity to have gone to the Circuit, 28 U.S.C. § 1292(a)(1) and Fed. R. Civ. P. 62(c).

This Court has repeatedly made new interpretations prospective; see *Gelpcke v. Dubuque*, 68 U.S. 175, 17 L. Ed. 520 (1864). The Court has recently applied the principle of fair reliance in the criminal field, *Johnson v. New Jersey*, 384 U.S. 719, 86 S. Ct. 1772, 16 L. Ed. 2d 882 (1966); and Professor Moore stresses the equal applicability of the principle in civil cases:

"Where title to land or commercial transactions are involved, demanding stability because of general reliance upon past precedent, the overruling decision should be given only prospective effect." 1B J. Moore, *Federal Practice* 203-04, and see also 209 (2d ed. 1965).

See also *England v. Board of Medical Examiners*, 375 U.S. 411, 422, 84 S. Ct. 461, 11 L. Ed. 2d 440 (1964), a direct holding that an interpretation would not be applied retroactively where a party had reasonably relied on a different understanding; and see also *Great N. Ry. v. Sunburst Oil & Ref. Co.*, 287 U.S. 358, 53 S. Ct. 145, 77 L. Ed. 360 (1932). This Court has stressed the importance of avoiding applications of law resulting in "prejudice" to "those who might have relied on" earlier understanding, *James v. United States*, 366 U.S. 213, 221, 81 S. Ct. 1052, 6 L. Ed. 2d

246 (1961), and has said that the same principles apply in civil and criminal litigation in this regard, *Linkletter v. Walker*, 381 U.S. 618, 85 S. Ct. 1731, 14 L. Ed. 2d 601 (1965). See generally and helpfully, Note, *Prospective Overruling and Retroactive Application in the Federal Courts*, 71 Yale L. J. 907 (1962).

The Government, well aware of its position in *National Supply*, and as if to anticipate this suggestion, says at p. 11 of its brief:

"... and for many years the Commission has regarded an exchange of securities such as was involved in the consolidation of National Life and Producers Life as constituting a 'purchase' or 'sale' of securities under the antifraud provisions of the Securities Exchange Act of 1934 and the Securities Act of 1933."

The only cases cited by the Government, as it notes, are recent; they were decided after this merger occurred. The evidences cited of the Commission's "many years regard" are two releases, Nos. 3965 (1958) and 4115 (1959). The first is a proposed revision of Rule 133 which in its terms does not bear on this matter, but which does contain some language by way of "staff recommendation" hostile to the no sale rule. The second is simply the language of revised Rule 133 which contains nothing at all on this point. Intriguingly, the Commission had what was from its point of view a better release, No. 3420, which really is hostile to the no-sale rule, dated August 2, 1951. Symbolic of the unsoundness of this kind of law-making by release is the fact that we discovered No. 3420 in the course of research for this brief, and the Commission, for whatever reason, has not as yet cited it in this case at all.

This, we must respectfully submit, is lawmaking by rumination. Surely practical men of affairs cannot be seriously expected to govern themselves by SEC "staff recommendations" which never result in a regulation on point. The SEC presented its no sale policy by a formal report endorsed by the Chairman of the Commission. It made that policy concrete and saw it into the law by a brief directed to the proposition in the Ninth Circuit. It expressly

and in precise terms took the problem to Congress, acknowledging its lack of jurisdiction and suggesting that Congress make a change if one was desired. It is simply too much to ask the business community to know that all this is reversed because the unidentified anonymities who make up "staff" are dissatisfied, particularly when they never persuaded the Commission to adopt their dissatisfaction in any express rule. To borrow the biting language of Justice Cardozo, dissenting on other matters only, in *Panama Ref. Co. v. Ryan*, 293 U.S. 388, 434, 55 S. Ct. 241, 79 L. Ed. 446 (1935), this is "a non-existent mandate," and assuming *arguendo* that the Commission's new policy now has status, "One must deplore the administrative methods that brought about uncertainty for a time as to the terms of executive orders intended to be law."

III. *The McCarran Act does Preclude the SEC's Attack upon this Merger of Two Arizona Insurance Companies.*

A. *Introduction.*

Section 2(b) of the McCarran Act provides that "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance," with exceptions not material here. Acting under a state statute which deals expressly and precisely with mergers of insurance companies, the Arizona Director of Insurance has said that a given insurance company, National Producers Life, may exist. The SEC asks for a court order that it may not exist. One would be hard put to contrive any method of more totally impairing or superseding the state law than this.

But, says the Commission, the McCarran Act preserves to the states only those matters of insurance regulation which historically the states have managed. *Maryland Cas. Co. v. Cushing*, 347 U.S. 409, 74 S. Ct. 608, 98 L. Ed. 806 (1954), dissenting opinion, (Black, J.) puts it succinctly: "The Act rather shows the strong purpose of Congress to permit states to continue regulating insurance as they always had." What, according to the SEC, are

the subjects of these regulations? "Historically, such matters as the chartering and licensing of insurance companies; the insurance rates; the content, form and issuance of insurance policies. . ." (SEC Br. 17). For all functional purposes, that is precisely what is here involved—by approving the merger of National Life into Producers, the Director was permitting National Producers Life to do business just as if it were being licensed. When the McCarran Act was passed in 1945, superintendence and control of mergers was a standard function of many insurance departments.¹⁰ Many of these focused on policyholder interests, but Arizona's Act, adopted in 1954 after the McCarran Act, expressly reaches shareholder interests as well.¹¹

Insurance mergers have been commonly considered beyond federal control when the states had overlapping regulations. The Senate Judiciary Committee, Subcommittee on Antitrust and Monopoly, held extensive hearings on the insurance industry in the 86th Congress, First Session. In a letter to Senator Joseph C. O'Mahoney, Victor R. Hanson, then Assistant Attorney General, Antitrust Division, said:

¹⁰ In 1945 at least fifteen states regulating insurance company mergers by insurance code (as distinct from corporate code) provisions were:

ARKANSAS, Pope's Ark. Stat. § 7682 (1937);
ILLINOIS, 73 Smith-Hurd Ill. Ann. Stat. §§ 768-82 (1961);
KANSAS, Kans. Stat. Ann., ch. 40, § 309 (1964);
MAINE, Me. Rev. Stat., ch. 56, § 4 (1944);
MASSACHUSETTS, Mass. Gen. Laws Ann., ch. 175, §§ 19A-C (1958);
MICHIGAN, 3 Mich. Com. Laws § 511.20 (1948);
MINNESOTA, Minn. Stat. §§ 60.55-57 (1945);
MISSOURI, Mo. Rev. Stat. § 6052 (1939);
NEW YORK, 27 McKinney's Laws of N. Y. Ann. §§ 480-504 (1966);
NORTH CAROLINA, N. C. Code § 217(n) (1935);
NORTH DAKOTA, N. D. Code Ann. § 26-20-01 to -08 (1960);
OKLAHOMA, Okla. Stat. tit. 36, §§ 81-91 (1951);
PENNSYLVANIA, Purdon's Pa. Stat. Ann., tit. 40, §§ 455-459a (1954);
TEXAS, Vernon's Tex. Stat., art. 5040, 41 (1936); and
WISCONSIN, Wis. Stat. § 206.38 (1945).

¹¹ In addition, A.R.S. § 20-615(4) authorizes the Director of Insurance to put a company into receivership if it merges "without having first obtained the written approval of the director."

"However, the *National Casualty* case does indicate that the limits which the McCarran Act imposes upon our jurisdiction to deal with insurance company activities which are subject to state regulation, exist without regard to how effective such regulation may be. For example, we recently considered a proposed merger (which had been reported in the press) between a large property insurance company and a life insurance company. Since the pertinent state insurance statutes contain a so-called Little Clayton Act, we concluded that the Clayton Act was not applicable to the merger."¹²

Referring to the instance described in the letter quoted above:

"Mr. McHugh. I understand you told us, Mr. Bicks, you concluded as a result of this study that the mergers did have anti-competitive implications which may be injurious to the public, and nevertheless the Department of Justice concluded it was powerless to act under the Clayton Act because of the presence of state laws in this area.

"Mr. Bicks.¹³ That is true." Insurance Hearings, *supra*, at 933.

See also the Statement of Federal Trade Commission Chairman John Gwynne:

Mr. McHugh. " . . . Judge Gwynne, do you construe the *American Hospital* and *National Casualty* cases as ousting the Federal Trade Commission from jurisdiction where the states have their own 'little antitrust acts' which do not by their terms apply to insurance?"

Mr. Gwynne. "I think the whole intent of the McCarran Act was to give the control of the insurance to the states, insofar as it could be done.

"I have always felt that if a state adopts a law that covers the field and constitutionally may cover the field that the federal government is not required to examine as to how they are enforcing it unless, as the Supreme Court says, it is a mere pretense.

¹² Hearings on the Insurance Industry Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 86th Cong., 1st Sess., pt. 2, at 931.

¹³ Assistant Attorney General, Antitrust Division. The Mr. McHugh is Donald P. McHugh, subcommittee counsel, who concluded that the federal government should be authorized to enter the merger field; Maloney, *Federal Regulation of Insurance*, 1960 *Ins. L. J.*, at 363, 369.

"I think that, to answer your question directly I think any statute which in effect practically regulates the activities which the Commission also has authority to regulate would oust the Commission of jurisdiction." *Id.* at 953-54.

It may be that Congress will conclude that state regulation of insurance mergers is inadequate; it has squarely faced the problem, but has so far declined to act. See Senate Comm. on Judiciary, Insurance: Aviation, Ocean Marine, and State Regulation, S. Rep. No. 1834, 86th Cong., 2d Sess. (1960), which is very critical of state insurance merger regulation, and particularly p. 216. But the Committee's point is that if change is needed, the McCarran Act must be amended:

"Stern necessity may require that the federal government assume a more enforceable role in insurance mergers. The Anti-trust Division of the Department of Justice continues to assert that one of its foremost if not principal responsibilities is to check in its incipency the substantial lessening of competition resulting from mergers and acquisitions. It is evident that State insurance departments have devoted little time to these considerations. In many cases they are not technically equipped to handle the problem. Serious questions exist as to their power under state law to cope with the myriad complexities of large mergers. Against this background, the responsibility of the Federal Government looms large in achieving uniformity of policy, filling the vacuum resulting from defects in State authority, and protecting our competitive economy from the inroads of concentration. *This is clearly an area where amendments to the McCarran Act may be needed.* To date, the anti-trust enforcement agencies have not seen fit to request additional authority in the insurance field. Developments in the industry in the immediate future and the experience of the Federal Government under the present law will determine the ultimate need for any change." *Id.* at 226 (emphasis added).

B. The McCarran Act Bars Federal Supersession of State Insurance Laws:

The spirit of the McCarran Act is recognized in the majority opinion in *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959), in which Justice Douglas for the Court said:

"We start with a reluctance to disturb the state regulatory schemes that are in actual effect, either by displacing them or by superimposing federal requirements on transactions that are tailored to meet state requirements. When the States speak in the field of 'insurance,' they speak with authority of a long tradition. For the regulation of 'insurance,' though within the ambit of federal power, (*United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 64 S. Ct. 1162, 88 L. Ed. 1440), has traditionally been under the control of the States." 359 U.S. at 68-69.

The legislative history is developed in the dissenting opinion in that same case in language which we think a majority would equally accept, as follows:

"In 1944, this Court removed the supposed constitutional basis for exemption of insurance by holding, in *United States v. South-Eastern Underwriters Ass'n*, supra, that the business of insurance was subject to federal regulation under the commerce power. Congress was quick to respond. It forthwith enacted the McCarran Act, 59 Stat. 33, 15 U.S.C. §§ 1011-1015, 15 U.S.C.A. §§ 1011-1015, which on its face demonstrates the purpose 'broadly to give support to the existing and future state systems for regulating and taxing the business of insurance.' *Prudential Insurance Co. v. Benjamin*, supra, 328 U.S. at page 429, 66 S. Ct. at page 1155, and 'to assure that existing state power to regulate insurance would continue.' *Wilburn Board Co. v. Fireman's Fund Ins. Co.*, supra, 348 U.S. at page 319, 75 S. Ct. at page 373. Thus rather than encouraging Congress to enter the field of insurance, the South-Eastern decision spurred reiteration of its undeviating policy of abstention." 359 U.S. at 99.

The McCarran Act is comprehensive legislation. It is applicable "to federal statutes now in existence," and to "any federal statutes

which may be enacted in the future."¹⁴ The statute was enacted because Congress did not wish "to take upon itself the responsibility of interfering with the taxation of insurance or the regulation of insurance by the States."¹⁵ Whenever the state legislates "specifically . . . upon a particular point," the state legislation prevails even if it conflicts with an Act of Congress.¹⁶

The general principles of the McCarran Act have been repeatedly upheld and applied. "Unless a Federal statute is made specifically applicable to the insurance business, it shall not 'invalidate, impair or supersede' any State insurance law." *Allstate Ins. Co. v. Lanier*, 361 F.2d 870, 872-73 (4th Cir. 1966). The guiding principle is that "Where there is an applicable state statute, the federal legislation does not apply." *Transnational Ins. Co. v. Rosenlund*, 261 F. Supp. 12, 26 (D. Ore. 1966). See also *North Little Rock Transp. Co. v. Cas. Reciprocal Exch.*, 181 F.2d 174 (8th Cir. 1950) (state rating bureau upheld as against Sherman Act); *California League of Independent Ins. Producers v. Aetna Casualty*, 175 F. Supp. 857 (N.D. Cal. 1959) (similar).

We cannot share with the Commission its sense of the relevance of the holdings in *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959), commonly referred to as *VALIC*, or *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 87 S. Ct. 1557, 18 L. Ed. 2d 673 (1967). These cases

¹⁴ Excerpt from discussion between Senators Murdock and Ferguson, 91 Cong. Rec. 479 (1945).

¹⁵ *Id.* at 481, Senator Ferguson.

See the observation of SEC Commissioner Sumner T. Pike before the Temporary National Economic Committee, making certain suggestions for the regulation of insurance. Commissioner Pike said:

"It should be made clear at this stage, however, that in offering the above suggestions, there is no desire on our part to increase the powers of the Securities and Exchange Commission. The Commission has already several acts to administer and the addition of insurance problems to its already complex duties would so overburden the staff and the Commissioners as to prevent the Commission from doing an adequate job in the fields to which it is already assigned." S. Doc. No. 35, 77th Cong., 1st Sess. 596 (1941).

¹⁶ *Id.* at 1481, Senator Ferguson.

involve the distinction between security investments and insurance; they dealt with the "basic difference between a contract which to some degree is insured and a contract of insurance," 387 U.S. at 211. The investment contracts were held not to be insurance and did not involve the "business of insurance." As the Commission said in its brief in *VALIC*:

"The basic reason why the McCarran-Ferguson Act has no effect on the federal security acts in this case is that the contracts here involved are not insurance and the respondents are not primarily engaged in the insurance business." Brief of Petitioner at 55, *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959).

Moreover, whether the state really had any relevant regulation was in issue in both *VALIC* and *United Benefit*. The SEC in *VALIC* emphasized that the District of Columbia Insurance Code contained no prospectus requirements for the purchasers of variable annuities, no requirement for independent directors, no requirement for the adoption of fundamental investment policies, and nothing similar to other provisions of the Investment Company Act; see SEC Br. 9-11 in *VALIC*, *supra*. In the instant case, the Arizona Insurance Department has very direct responsibility for the interests which the SEC wishes to protect.

C. *The Arizona Insurance Code Contains Direct Provisions Which are Impaired or Superseded by the SEC Action.*

The SEC stresses that "The traditional thrust of state insurance regulation has been the protection of policyholders, not stockholders," citing to the concurring opinion of Mr. Justice Brennan in *VALIC*, *supra*, 359 U.S. at 78-79. Whatever the weight of this observation may be in other jurisdictions, the Arizona law categorically makes it the duty of the Director of Insurance, in passing upon a merger, to consider whether the consolidation would be

"inequitable to the stockholders of any domestic insurer involved." A.R.S. § 20-731B.2.¹⁷

If states are to enjoy their McCarran Act privileges, they must have good faith legislation in the general area of the federal legislation.¹⁸ As Senators Barkley and McCarran developed in the discussion of the McCarran Act on the floor, it is not enough for the states simply to act "by going through the form of legislation."¹⁹ On the other hand, the state legislation does not have to be identical to the federal regulations; see *FTC v. National Cas. Co.*, 357 U.S. 560, 564, 78 S. Ct. 1260, 2 L. Ed. 2d 1540 (1958). Here, as there, "petitioner does not argue that the statutory provisions here under review were mere pretense."

We come then to the fundamental question of this case: Which administrative and court system of the United States is to have jurisdiction to decide whether these companies may merge? Will

¹⁷In Appendix B to our Opposition to the Petition for Certiorari in this case, we classified the 50 states on mergers, with full citations. Thirteen, including Arizona, have merger provisions specifically directed to the investor interest, and also have fraud control provisions; ten have either no or limited merger control provisions; and the remainder do not specifically refer to consideration of rights of stockholders. The "traditional" thrust to which the SBC refers harks back to the day when most life insurance companies were mutuals, and policyholder protection thus included stockholder protection. The increasing attention to stock problems of insurance companies by state regulatory legislation is a reflection of the shift in the nature of the industry from mutual to stock companies. Only 20 of the 1,500 stock companies now in existence were formed before the turn of the century. Prior to World War II, stock insurance companies were responsible for only 20% of the life insurance in force in this country, while today there are 1,551 stock insurance companies which carry 45% of the life insurance in existence in the United States. For current descriptive detail, see *Institute of Life Insurance, Life Insurance Fact Book* 98 (1967), and for historical background, see A. Milton, *Life Insurance Stocks: An Investment Appraisal*, 37-65 (1965).

¹⁸*Cf. United States v. Sylvanus*, 192 F.2d 97 (7th Cir. 1961), a mail fraud case in which the state insurance director had no criminal remedy as against an insurance company officer who engaged in fraudulent advertisements. The state regulation must also be effectively operative within the state's own borders, *FTC v. Travelers Health Ass'n*, 362 U.S. 293, 80 S. Ct. 717, 4 L. Ed. 2d 724 (1960).

¹⁹See Barkley-McCarran exchange, 91 Cong. Rec. 1444 (1945).

it be the SEC and the federal courts, or the state insurance department and the state courts? As Justice Curtis said in a familiar passage, "Let it be remembered, also—for just now we may be in some danger of forgetting it—that questions of jurisdiction were questions of power as between the United States and the several states."²⁰ Who has the power to decide this specific question?

This in turn leads to the *precise* questions which need to be decided. As the Government brings the case to this Court, the merger should be set aside because, in appealing to its shareholders for proxies to support the merger, Producers is alleged to have made four nondisclosures or misleading statements concerning material matters. All four of these are put in issue by the pleadings, and someone therefore must decide these things:

(a) Did National Securities in fact fail to disclose the obligations on the non-compete agreements? Should it have disclosed earlier losses, and did it? Did it erroneously include a given asset? And did it fail to disclose how the value of stock had been handled by National Life in the 1964 annual report?

(b) Assuming *arguendo* that one or more of these treatments of matters of fact was erroneous, is this of sufficient consequence to bar the merger?

These matters were before the Director of Insurance under directly applicable State law. The ultimate question is merger or no merger. A.R.S. § 20-731, set forth in the Appendix, expressly requires domestic stock insurers (which these were) to obtain the written approval of the Director of Insurance for any mergers. The Director is required to consider whether the merger will be "contrary to law"; or "inequitable to the stockholders of any domestic insurer involved"; or "would substantially reduce the security and service to be rendered to policyholders of the domestic insurer in this state or elsewhere." If the fundamental implications of the SEC's charges are well taken, then the merger would

²⁰ As quoted on the frontispiece of *F. Frankfurter & H. Shulman, Cases and Other Authorities on Federal Jurisdiction and Procedure* (rev. ed., Callaghan & Co., 1937).

be all of these things—it would be contrary to law, it would be inequitable to stockholders, and it would reduce the security of and service to be rendered to policyholders.

Misleading statements are "contrary to law" as an express violation of two Arizona statutes; see Appendix to this brief. The first is A.R.S. § 20-444A, which makes it illegal to distribute any statement relating to insurance which is "untrue, deceptive or misleading." The second is A.R.S. § 20-443(3), which makes it unlawful to make "any misleading representation or any misrepresentation as to the financial condition of any insurer." These provisions are part of Title 20, ch. II, art. 6 of the Arizona Code, which by its preface shows that it was expressly adopted for the purpose of complying with the McCarran Act and of taking up the responsibilities recognized by Congress in that statute.²¹

The fundamental flaw in the SEC position is its bland assumption that a state power does not exist if it is not exercised as the Commission would like to see it exercised. As proof that the state does not have adequate power in this field, the SEC says, Br. 12-13, that "Indeed, in this very case the State insurance commissioner, approved the merger under a statute which prohibits 'untrue, deceptive or misleading' statements 'with respect to the business of insurance,' even though the Commission had submitted to him 'all of the pleadings and evidentiary materials which had been before the Federal District Court' (Br. in Opp. 4), which alleged that seriously false and misleading information was being used in soliciting stockholders' consents to the merger."

²¹ The SEC suggests that Arizona's "Little McCarran Act" is somehow inapplicable because it is "directed toward unfair practices and frauds in the transaction of an insurance business." The Act is in fact carefully and scrupulously as broad as the McCarran Act, regulating "all" practices of the offending types "in the business of insurance." Sponsored by the National Association of Insurance Commissioners to meet McCarran Act standards, and called the All Industries Fair Trade Practices Act, the provisions have been adopted in a number of states. For a table enumerating thirteen states with laws similar to Arizona's, though not in all cases identical, with respect to fraud controls, see Appendix B to our Opposition to the Petition for Certiorari.

The assumption that the State must be powerless if it disagrees shows consummate self-satisfaction by the Commission with its own omniscience.

But the fact that the State Insurance Director evaluated these materials differently than would the SEC does not mean that he was powerless to make the judgment. He was free to conclude that the particular statements were either never made, or were not deceptive, or were inconsequential or that there was no false and misleading information. Under an elaborate state insurance code, he made that very decision; and to reverse him by federal court action is "to invalidate, impair, or supersede" the Arizona laws regulating the business of insurance.²² Let us leave the matter

²² The Ninth Circuit decision is thus read in *Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co.*, 67 Civ. 4855, an extensive opinion by Judge Herlands in the Southern District of New York, July 30, 1968, as yet unreported. The case, dealing with the application of the McCarran Act to the Federal Arbitration Act, said:

"*SEC v. National Securities Inc.*, 337 F.2d 25 (9th Cir. 1967), affirming 252 F. Supp. 623 (D. Ariz. 1966), upon which respondent principally relies, does not dictate a contrary result. In that case, the Securities and Exchange Commission sought to invalidate the merger of two stock life insurance companies on the ground that the anti-fraud provisions of the Securities Exchange Act of 1934 were violated. The District Court merely held that application of the Federal Act 'would at least "impair," if not "invalidate" or "supersede" an Arizona statute enacted for the purpose of regulating the business of insurance, which contains the specific requirement that any proposed merger of insurance companies must be approved by the state director of insurance. (252 F. Supp. at 626). The Court of Appeals noted that the State of Arizona had 'affirmatively asserted its power to regulate the merger of insurance companies' (387 F.2d at 31) and that the legislative history of the 1964 amendments to the Securities Acts indicate that the States were to be given an opportunity to demonstrate their ability to effectively protect the investors as well as the policyholders.' (1964 U.S. Code Cong. & Admin. News, p. 3022, quoted in 387 F.2d at 31, n. 3). The Court of Appeals, therefore, affirmed the District Court's holding that application of the Securities Exchange Act of 1934 would impair, invalidate or supersede the Arizona law. (387 F.2d at 32). The Court did not hold that the Securities Exchange Act of 1934 was inapplicable for the reason that it does not contain a provision making it applicable to insurance. *What National Securities, Inc. did hold was that the federal statute did not govern because it impaired a detailed state regulatory scheme specifically and directly aimed at the insurance business.*" (Emphasis added.)

with a rhetorical question for the SEC: How would it be possible more completely to impair or supersede the Director's power than to set aside a merger he allowed? If the SEC did wish to impair or supersede A.R.S. § 20-731, what else could it do?

IV. *Proxy Solicitations for a Merger are not Covered by § 10(b) of the Securities Exchange Act of 1934 or Rule 10b-5.*

This is an action to nullify a merger, allegedly because of improper proxy solicitations, brought under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 issued under that Act. The 1934 Act gives the Commission a mighty arsenal of weapons, and not all of them are in any one section or in any one rule. Rule 10b-5 deals with certain frauds in the purchase and sale of securities. On their face, neither the statute nor the rule deals with proxy solicitation at all. The proxy section is § 14(a) of the Act, 15 U.S.C. § 78n, and Rule 14a(1) through (12), of which Rule 14(a)(9) deals with misleading statements. Section 14 of the Act as it appeared prior to the 1964 amendments made it a violation of the Rules of the Commission to solicit proxies "in respect of any security . . . registered on any national securities exchange." No security of either of the insurance companies here involved was registered on a national exchange, and therefore the Commission could not and did not attempt to assert jurisdiction under the proxy rules.

Section 14 was broadly extended in 1964, 78 Stat. 565 (App. to this brief).²³ The amendment, which by virtue of SEC Regulation 12h-1, 17 C.F.R. 240.12h-1, took effect with respect to insurance companies in 1966, extended proxy controls to companies whose securities are sold over-the-counter, but exempted insurance

²³ The principal effect of the Securities Acts Amendments of 1964 flows from the addition to § 12 of the 1934 Act of subsection (g)(1) which requires registration with the SEC by any company having total assets exceeding \$1,000,000 and more than 500 holders of any class of its equity securities (15 U.S.C. § 78l(g)(1)). At the same time § 14(a) of the 1934 Act was amended to make the proxy rules applicable to any company registered under § 12 (15 U.S.C. 78n(a)).

companies where a substantially equivalent state regulation is in effect (78 Stat. 565, 15 U.S.C. § 78l(g)(2)(G), App. to this brief). Upon the passage of the 1964 Act, the National Association of Insurance Commissioners prepared uniform proxy regulations for use by the insurance commissioners of each state, and all fifty states have now adopted either regulations or statutes to this general effect; see 2 CCH Fed. Sec. L. Rep., para. 23, 310. For example, Arizona adopted a statute which referred explicitly to the 1964 amendment and authorized appropriate issuance of proxy regulations, A.R.S. § 20-143. The Insurance Director promptly issued general Rule No. 66-12 ("Regulations Regarding Proxies, Consents and Authorizations of Domestic Stock Insurers"), a detailed regulation of some 5,000 words.

Once again, the Government sees the issue differently. The Government says "§ 10(b) is directed against fraud in connection with the purchase or sale of securities, whether or not such fraud involves a proxy solicitation" (SEC Br. p. 30). We say, just exactly how does § 10(b) cover proxy solicitations at all? The Government has cited no cases either in the lower courts or here supporting the proposition that § 10(b), rather than § 14, reaches proxy solicitations in any way, and so far as we know, there are no such cases. The only two cases prior to this one dealing with the subject either hold or suggest that § 14, which is expressly the proxy section, rather than § 10(b) is the appropriate section for proxy control. In *Borak v. J. I. Case Co.*, unreported in the District Court, *rev'd on other grounds*, 317 F.2d 838 (7th Cir. 1963), *aff'd*, 377 U.S. 426, 84 S. Ct. 1555 (1964), the District Judge said:

"... The facts which plaintiff alleges as constituting a violation of § 10b, that is the soliciting of proxies by means of a proxy statement containing false and misleading statements and omissions of fact, constitutes, if true, a violation of § 14a and not of § 10b. It is § 14a and not § 10b which protects the

stockholders right to full and fair disclosure in corporate elections by proxy."²⁴

See also *Barnett v. Anaconda Co.*, 238 F. Supp. 766, 776 (S.D.N.Y. 1965), saying: "Section 14(a) is specifically designed to deal with deceptive proxy material and consequences flowing therefrom. There is nothing here to justify any contention that 10(b) and Rule 10b-5 and § 17(a) provide enlarged or different remedies for what are merely violations of § 14(a)."²⁵

The 1964 amendments are expressly based on a special study by the Commission, of which the relevant portion is House Doc. No. 95, pt. 3, pp. 40-41, 88th Cong., 1st Sess., in which the Commission dealt, among other things, with the need of coverage of insurance companies. In its discussion of proxy materials as they relate to insurance companies, the Commission expressly asserted that the proxy materials used in connection with such companies were inadequate by Commission standards. The Commission said:

"In 15 instances, matters other than election of directors are to be voted on—*mergers*, options, retirement plans, etc.; there was not one solicitation which contained information approaching that required by the Commission proxy requirements."

(Emphasis added.)

Again, in the statement made by SEC Chairman William L. Cary, before the Senate Committee on Banking and Currency, various statements of the Commission itself were presented. One of these, a statement by the Commission staff relating to § 14, expressly cited mergers as illustrative of the need for broadening the proxy controls; see *Federal Securities Law Reports*, CCH, No. 905, pt. 1, June 20, 1963, p. 89.

²⁴ Unreported opinion deposited with the Clerk of the District Court in this case.

²⁵ In the instant case the District Court seems to suggest, but did not decide, that he thought § 10(b) inapplicable to proxy solicitations; see App. 141.

Why did the Commission tell the Congress that it needed to amend the Exchange Act to make the proxy rules applicable to mergers of over-the-counter companies if it already had that power under § 10(b)?²⁶ If, as it now contends, it has power over this subject matter under both sections, surely it was disingenuous not to have acknowledged it to the Congressional committee.

We offer the argument based upon § 14(a) and the 1964 amendment for two purposes:

(a) The inapplicability of § 10(b) to proxy solicitations is an independent ground for affirming the decision of the court below, quite apart from the McCarran Act;

(b) The scrupulous care with which Congress left proxy regulation to the states in connection with the 1964 amendments is further evidence of the McCarran Act policy of Congress. As the opinion of the Court of Appeals shows by quotation from the House Committee Report, the exclusion of insurance companies from proxy control by the SEC avoided "departure by the bill from the doctrine embodied in the McCarran Act that regulation of insurance companies be left to the states."

V. *The Writ of Certiorari was Improvidently Granted.*

There is no suggestion that there is another case in America involving proxy solicitations for a merger of insurance companies.

²⁶ The proxy problem interlocks very closely with the "no sale" problem. In 1941, when Congress was considering whether to extend § 10(b) to mergers by broadening the concept of sale, the bankers, security dealers, and exchanges advised that this was unnecessary because the § 14 proxy rules would apply "in the case of mergers, consolidations or reorganizations" for "all corporations who have securities registered on a national securities exchange." (Hearings on H.R. 4344, H.R. 5065, and H.R. 5832 Before the House Comm. on Interstate and Foreign Commerce, 77th Cong., 1st Sess., pt. III, at 846, 848 (1941).) This was quite true as to those corporations. The statement continues with direct reference to mergers, enumerating all the proxy requirements which the SEC in the instant case seeks to impose under § 10(b) but which were there said to flow from § 14. The 1964 amendment did extend § 14 to the class of companies earlier excluded—but conditionally exempted insurance companies.

If such a case arose, it would now clearly be governed by the 1964 Act, for every state has now adopted regulations pursuant to the 1964 amendment. We appreciate that there are substantial questions in this case which could be decided, as for example the "no sale" issue or the McCarran Act issue or the scope of 10(b) as it relates to proxies. But in the circumstances all of these determinations are advisory, for however they are decided, any future similar case will involve first and foremost the new proxy statute. While we realize that this Court has more than tentatively decided that the matter is important by granting the writ of certiorari, we suggest that upon closer acquaintance after oral argument, this is an appropriate case for dismissal of the certiorari; see for collected authorities, *R. Stern & E. Gressman, Supreme Court Practice* 190-93 (3d ed. 1962).

CONCLUSION

It is respectfully submitted that the judgment of the Court of Appeals should be affirmed.

LEWIS ROCA BEAUCHAMP &
LINTON

By: John P. Frank
A. Gordon Olsen

114 West Adams
Phoenix, Arizona 85003

August, 1968.

APPENDIX A

McCarran-Ferguson Act, 59 Stat. 33-34, 15 U.S.C. § 1011-13

Sec. 1. *Declaration of policy*

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

Sec. 2. *Regulation by State law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948*

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

Sec. 3. *Suspension until June 30, 1948, of application of certain Federal laws; Sherman Anti-Trust Act applicable to agreements to, or acts of, boycott, coercion, or intimidation*

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the

Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce or intimidate, or act of boycott, coercion, or intimidation.

§ 10b of Securities and Exchange Act of 1934,
48 Stat. 881, 15 U.S.C. § 78j

Sec. 10. *Manipulative and deceptive devices*

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC Rule 10b-5, 17 C.F.R. 240.10b-5

Employment of manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any

person, in connection with the purchase or sale of any security.

Securities Acts Amendments of 1964,

78 Stat. 565-69, 15 U.S.C. §§ 78l(g), 78n

Sec. 3. (c) Section 12 of said Act is further amended by adding thereto the following new subsection.

(g)(1) Every issuer which is engaged in interstate commerce, or in a business affecting interstate commerce, or whose securities are traded by use of the mails or any means or instrumentality of interstate commerce shall—

(A) within one hundred and twenty days after the last day of its first fiscal year ended after the effective date of this subsection on which the issuer has total assets exceeding \$1,000,000 and a class of equity security (other than an exempted security) held of record by seven hundred and fifty or more persons; and

(B) within one hundred and twenty days after the last day of its first fiscal year ended after two years from the effective date of this subsection on which the issuer has total assets exceeding \$1,000,000 and a class of equity security (other than an exempted security) held of record by five hundred or more but less than seven hundred and fifty persons, register such security by filing with the Commission a registration statement (and such copies thereof as the Commission may require) with respect to such security containing such information and documents as the Commission may specify comparable to that which is required in an application to register a security pursuant to subsection (b) of this section. Each such registration statement shall become effective sixty days after filing with the Commission or within such shorter period as the Commission may direct. Until such registration statement becomes effective it shall not be deemed filed for the purposes of section 18 of this title. Any issuer may register any class of equity security not required to be registered by filing a registration statement pursuant to the provisions of this paragraph. The Commission is authorized to extend the date upon which any issuer or class of issuers is

required to register a security pursuant to the provisions of this paragraph.

(2) The provisions of this subsection shall not apply in respect of—

(G) any security issued by an insurance company if all of the following conditions are met:

(i) Such insurance company is required to and does file an annual statement with the Commissioner of Insurance (or other officer or agency performing a similar function) of its domiciliary State, and such annual statement conforms to that prescribed by the National Association of Insurance Commissioners or in the determination of such State commissioner, officer or agency substantially conforms to that so prescribed.

(ii) Such insurance company is subject to regulation by its domiciliary State of proxies, consents, or authorizations in respect of securities issued by such company and such regulation conforms to that prescribed by the National Association of Insurance Commissioners.

(iii) After July 1, 1966, the purchase and sales of securities issued by such insurance company by beneficial owners, directors, or officers of such company are subject to regulation (including reporting) by its domiciliary State substantially in the manner provided in section 16 of this title. . . .

Sec. 5. (a) Section 14(a) of the Securities Exchange Act of 1934 is amended to read as follows:

Sec. 14. (a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title.

SEC Rule 12h-1, 17 C.F.R. § 240.12h-1

A temporary exemption for insurance companies from compliance with the provisions of clause (ii) of section 12(g)(2)(G)

(a) An insurance company which meets the conditions specified in clause (i) of section 12(g)(2)(G) of the Act shall be exempt from registration under the provisions of section 12(g) thereof during the calendar year 1965 notwithstanding the fact that the conditions specified in clause (ii) of section 12(g)(2)(G) are not met during such period.

(b) Every insurance company exempted under paragraph (a) of this section and meeting the requirements of section 12(g)(1) as of the last days of a fiscal year ended on or after December 31, 1965, shall file a registration statement within 120 days after such fiscal year end unless all conditions of clauses (i) and (ii) and, after July 1, 1966, clause (iii) of section 12(g)(2)(G) of the Act are met, or the securities of such company are otherwise exempt from registration under section 12(g)(1).

SEC Rule 14a-9, 17 C.F.R. § 240.14a-9

False or misleading statements

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

ARIZONA REVISED STATUTES

ARTICLE 11. CONSOLIDATION OR MERGER

Sec. 10-341. *Consolidation authorized*

Two or more corporations may be consolidated, and continued as one of the constituent corporations or by forming a new corporation.

Sec. 10-342. *Consolidation agreement*

When two or more corporations desire to consolidate, a majority of the directors of each corporation affected may enter into an agreement setting forth the terms and conditions of the proposed consolidation, including:

1. Capitalization and number of shares of capital stock of the proposed consolidated corporation.
2. Classes into which the shares shall be divided and the value placed on each.
3. Manner of converting the shares and assets of the retiring corporations.
4. Whether one of the constituent corporations is to be continued or a new corporation formed.
5. Number of directors and officers.
6. Method of carrying into effect the terms of the agreement.
7. Other details necessary to disclose all matters affecting the consolidation.

Sec. 10-343. *Notice of proposed consolidation*

A. Notice of proposed consolidation of corporations shall be given by each corporation affected by publication in a newspaper published in the county in which its principal office is located, once each week for four successive weeks immediately prior to the meeting at which the proposed action is to be voted upon, and by mail to the last known address of each stockholder as shown by the books of the corporation, not less than thirty days prior to the meeting.

B. The notice shall contain:

1. The time and place of the meeting.
2. The value of the assets of the corporation.
3. The amount of its indebtedness.
4. A copy of the agreement of the boards of directors, as provided in § 10-342.

Sec. 10-344. *Submission of agreement to shareholders*

A. The agreement of the boards of directors to consolidate shall be submitted to the shareholders of each constituent corporation, who may vote in person or by proxy for the adoption or rejection thereof at either an annual or special stockholders' meeting.

B. If all outstanding shares in the corporation are of one class and of equal par value each share shall entitle the holder to one vote. If the shares are of different classes or of different par values, relative voting rights shall be upon such basis as the charter or bylaws of the corporation may provide, or in the absence of any express provision, then in the ratios of respective par values, treating each no par share, if any, as of a par value equal to the par value of the outstanding shares of the corporation of highest par value.

C. If two thirds of the stock, valued as provided by this section, is voted in favor of consolidation, the agreement shall be declared adopted and the vote certified on the agreement by the secretary of the corporation so voting. The agreement shall be signed and acknowledged by the president and secretary of the corporation, and its seal affixed thereto.

Sec. 10-345. *Formal requirements for consolidation*

A. If an agreement for consolidation, ratified and certified by each constituent corporation as provided in § 10-344, provides that one of the constituent corporations shall be continued as the consolidated corporation, the certified agreement shall be filed in the office of the corporation commission, and one copy thereof,

certified by the corporation commission, shall be recorded in the office of the county recorder of each county in which one of the constituent corporations has its principal office. The consolidation shall thereupon be deemed consummated and the separate existence*of the constituent corporations to have ceased, and the consolidated corporation shall become a single corporation in accordance with the agreement, under its articles and name, possessing all powers and subject to all restrictions and disabilities of corporations organized for profit.

B. If an agreement for consolidation, ratified and certified by each constituent corporation as provided in § 10-344, provides for the formation of a new corporation, new articles of incorporation, reciting the consolidation and naming the constituent corporations, shall be prepared and filed in the manner required by law.

Sec. 10-346. Transfer of assets and liabilities

All debts due to, and all property and assets of, each corporation consolidated as provided in this article shall vest in the consolidated corporation, but rights of creditors against and liens on the property of each corporation consolidated shall be preserved unimpaired. The debts, liabilities and duties of the corporations consolidated shall pass to the consolidated corporation, and may be enforced against it in the same manner and to the same extent as if incurred or contracted by, or imposed upon it.

Sec. 10-347. Payment for shares of dissenting shareholders; valuation

A. Any shareholder of the corporations consolidating who votes to reject the agreement, and who does not consent to the agreed manner of converting the shares of stock, shall be paid in cash the fair value of his stock, based on its pro rata share of the fair value of the net assets of the corporation of which he is a shareholder as of the time of the consolidation meeting. In the event of disagreement, such value shall be determined by the

court in an action by either the dissenting shareholder or the corporation, and the corporation's existence shall be continued for that purpose.

B. Every shareholder shall be deemed to have consented to such method of conversion unless he gives written notice of dissent to the president, secretary or statutory agent of the corporation not later than two days after the consolidation meeting, and unless he commences an action in the superior court of the county in which the principal office of the corporation is located to fix the value of his shares, not later than thirty days after such meeting. After the hearing the court shall determine the value of the dissenting stock, and the corporation shall pay the owner the sum so determined within thirty days after final judgment, whereupon the stock shall be transferred to the corporation. . . .

Sec. 10-349. *Effect of merger or consolidation; rights of shareholders*

B. The provisions of this article shall apply to the rights of shareholders of any one or more of the constituent corporations which are domestic corporations.

Sec. 20. INSURANCE

Sec. 20-143. *Rule-making power* (as amended 1966)

A. The director may make reasonable rules and regulations necessary for effectuating any provision of this title.

B. The director shall make regulations concerning proxies, consents, or authorizations in respect of securities issued by domestic stock insurance companies having a class of equity securities held of record by one hundred or more persons to conform with the requirements of section 12(g) (2) (G) (ii) of the Securities Exchange Act of 1934 as amended, and as may be amended. Such regulation shall not apply to any such company having a class of equity securities which are registered or are

required to be registered pursuant to section 12 of the Securities Exchange Act of 1934, as amended, or as may be amended. Whenever such equity securities of any such company are registered or are required to be registered pursuant to section 12 of the Securities Exchange Act of 1934, as amended, or as may be amended, then, no person shall solicit or permit the use of his name to solicit, in any manner whatsoever, any proxy, consent or authorization in respect of any equity security of such company without having first complied with the rules and regulations prescribed by the Securities and Exchange Commission pursuant to section 14 of the Securities Exchange Act of 1934 as amended, or as may be amended.

Sec. 20-443. Misrepresentations and false advertising of policies

No person shall make, issue or circulate, or cause to be made, issued or circulated, any estimate, illustration, circular or statement:

3. Making any misleading representation or any misrepresentation as to the financial condition of any insurer or as the legal reserve system upon which any life insurer operates.

Sec. 20-444. False or deceptive advertising of insurance or status as insurer

A. No person shall make, publish, disseminate, circulate or place before the public, or cause, directly or indirectly, to be made, published, disseminated, circulated or placed before the public, in a newspaper, magazine or other publication, or in the form of a notice, circular, pamphlet, letter or poster, or over any radio or television station, or in any other way, any advertisement, announcement, sales material or statement containing any assertion, representation or statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his insurance business, which is untrue, deceptive or misleading.

Sec. 20-731. Merger or consolidation of stock insurers

A. A domestic stock insurer of any kind may merge or consolidate with another domestic or foreign stock insurer by complying with the provisions of general law governing the merger or consolidation of stock corporations formed for profit, but subject to subsection B of this section.

B. No such merger or consolidation shall be effectuated unless in advance thereof the plan and agreement therefor have been filed with and approved in writing by the director of insurance. The director shall give his approval within a reasonable time after filing unless he finds the plan or agreement:

1. Is contrary to law.
2. Inequitable to the stockholders of any domestic insurer involved.
3. Would substantially reduce the security of and service to be rendered to policyholders of the domestic insurer in this state or elsewhere.

C. If the director does not approve the plan or agreement he shall so notify the insurer in writing specifying his reasons therefor.

APPENDIX B

EXCERPTS FROM: SEC. REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART VII (1938)

The text of the report at p. 249 reads as follows:

"But although offers to exchange securities of one company for the securities of another, as in the case of Equity, are subject to these requirements of the Act, there are important types of voluntary plans which are not. For example, Section 3 (a) (9) of the Act specifically exempts securities 'exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange.' Furthermore, the registration and prospectus provisions of the Act ordinarily are not applicable to mergers, consolidations or sales of assets effected pursuant to the provisions of typical state statutes.¹⁷²"

To this text is appended footnote 172 which reads as follows:

"¹⁷² Although the Act is applicable to many reorganization situations, as, for instance, the solicitation of deposits of securities with protective committees, and the offering of new or modified securities in exchange for outstanding issues (where such offerings are not specifically exempted by Section 3 (a) (9)) its provisions were designed primarily to establish standards of disclosure in new financing and its mechanics were specifically adapted to that end. The registration and prospectus provisions of the Act are not applicable to such specialized reorganization situations as those presented where stockholders' proxies or assents are solicited in approval of the typical merger, consolidation, or sale of assets.

"Under Section 5 of the Act the registration and prospectus requirements apply where instrumentalities of interstate commerce or the mails are used to 'sell' securities. Section 2 (3) defines the term 'sell' to include 'every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. * * *'. The Commission's view has been that it is essential to a 'sale' under Section 2 (3) that the prospective purchaser

have the right individually and voluntarily to elect whether or not to purchase. In the case of the typical consolidation, merger, or sale of assets, this essential element of volition on the part of the individual shareholders is absent. The vote of a specified percentage of the stockholders whose proxies or assents are solicited will bind all to accept the new securities, subject only to such rights to appraisal and payment as may be afforded dissenters by state law or by provision in the certificate of incorporation. In casting their votes for or against the plan, the stockholders are not individually entering a contractual relationship, but are exercising (or are being bound by the exercise of) powers held by virtue of the legal relationship of the stockholders in their corporation.

"Moreover, the results of a contrary interpretation of the application of the Securities Act to consolidations, mergers, and sales of assets illustrate the inadaptability of its mechanics to such transactions. Such reorganizations in the case of consolidations and sometimes in the case of sales of assets contemplate the distribution to stockholders, in exchange for their holdings, of securities of a new corporation which would be formed only after the stockholders' approval of the plan had been secured. It is evident that if any protection is to be afforded stockholders by the registration and prospectus requirements of the Act, they must apply to the solicitation of binding proxies or assents from these stockholders. However, since the Act requires that the registration statement be signed by the 'issuer' and its principal executive officers, it is likewise evident that until there is an issuer in being no registration can be effected; thus, the registration provisions cannot apply at this time. Likewise, it is clear that registration of the securities of the new corporation after it was formed would be useless as a protection to security holders of the consolidating or selling corporations. At that time, their proxies already would have been secured; the vote would have been taken; and the plan would have been approved and become binding on the stockholders. Section 5 (a) (2) requires, however, that a registration statement be in effect if any security is carried through the mails or by any instrumentality of interstate commerce 'for delivery after sale.' Therefore, if the consolidation or sale of assets were deemed to involve a 'sale' of securities of the new corporation, Section 5

(a) (2) of the Securities Act would necessitate the registration of these securities before their distribution, and Section 5 (b) (2) would require that their delivery be accompanied or preceded by a prospectus meeting the requirements of the Act. But the stockholders would already be bound to take the securities. In other words, the only protection which the Securities Act purports to afford—the protection of adequate disclosure—would be afforded at the point of time when its utility was least.

"The Commission's views with respect to the application of the registration requirements of the Act to mergers, consolidations and sales of assets have been set forth in a note to its 'Rules As to the Use of Form E-1' for 'Securities in Reorganization.' The note states:

"The Commission deems no sales to stockholders of a corporation to be involved, within the meaning of the definition quoted in Rule 5 (2), [*i. e.*, within the meaning of Section 2 (3) of the Act] where, pursuant to the statutory provisions or provisions contained in the certificate of incorporation, there is submitted to the vote of such stockholders a proposal for the transfer of assets of such corporation to another person in consideration of issuance of securities of such other person, or a plan or agreement for a statutory merger or consolidation, provided the vote of a required favorable majority.

(a) will operate, so far as the corporation the stockholders of which are voting is concerned, to authorize the transfer or to effectuate the merger or consolidation (except for the taking of action by the directors of the corporations involved and for compliance with such statutory provisions as the filing of such plan or agreement with the appropriate state authorities), and

(b) will bind all stockholders of such corporation, except to the extent that dissenting stockholders may, under statutory provisions or provisions contained in the certificate of incorporation, be entitled to receive the appraised or fair value of their holdings.

The Commission deems it immaterial in these circumstances whether the person the securities of which are to be issued is in existence or not; whether, if such person is in existence, the plan, agreement or proposal is submitted by or with its au-

thority; or whether, in the case of transfer of assets, such securities are to be issued to stockholders directly or are to be distributed to them as a liquidating dividend or otherwise.

'When, in accordance with this Note, submission of a plan, agreement, or proposal to the vote of stockholders involves no sale to them, the Commission deems no sales to be involved in the delivery of securities to such stockholders.

'Accordingly, neither the submission to the vote of stockholders of a plan, agreement or proposal of the character specified in this Note, nor the delivery of securities thereunder to such stockholders, requires the registration of such securities or the delivery of a prospectus meeting the requirements of Section 10 of the Act.'"

In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 41

SECURITIES AND EXCHANGE COMMISSION, PETITIONER

v.

NATIONAL SECURITIES, INC., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

1. The respondent accuses the Commission of a "serious injustice" in presenting this case "as if * * * [the lower] courts had held that the [McCarran-Ferguson] Act * * * immunize[d] transactions in securities of insurance companies from the application of federal securities laws" (Br. p. 12). But this is certainly a reasonable conclusion from the rationale of the court of appeals, reflected by its statement, referred to in our brief (p. 8), that in adopting the McCarran Act "Congress was apparently seeking to define an exemption for insurance continuous with its power to regulate interstate commerce"

(App. 156), as well as by its statement that a "vital" purpose of that Act was "to preserve intact from any federal intrusion based on the commerce clause, existing and future State regulation of the insurance industry" (App. 157). The court of appeals did not base its decision on the alternative ground urged by the companies that "no sale" of securities took place in connection with the merger, or on the propriety of the relief requested. Accordingly, as we read the opinion, the court of appeals held that no provision of the federal securities laws is applicable to securities of insurance companies with respect to any matters as to which the States have exercised jurisdiction over those companies.

2. National Securities devotes a major portion of its brief (pp. 13-23) to the proposition that the merger did not involve any "sale" of securities. The court of appeals, however, stated that it was discussing "only one of the issues of law" involved—the application of the McCarran Act (App. 154). It noted "that the district court did not reach the question whether the consolidation of Producers Life and National Life into National Producers involved purchases or sales of securities in connection with which the alleged fraud occurred" (*ibid.*). Thus the question is not appropriately before this Court for decision (see footnotes 6 and 31 of our brief).

13. National Securities states (Br. pp. 30-31) that "the fundamental question of this case" is whether "the SEC and the federal courts, or the state insurance department and the state courts" "have juris-

3

diction to decide" whether insurance "companies may merge." This is unfounded. The Commission asserts no jurisdiction over mergers of insurance companies. It contends only that the federal courts may, at the suit of the Commission, enjoin or otherwise remedy fraudulent activities in the purchase or sale of insurance company securities, whether or not these occur in connection with a merger of insurance companies.

The Commission does not seek in any way to regulate or control "the business of insurance." It seeks only to protect investors against fraud in dealings in securities, whatever may be the business of the company whose securities are involved.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.

PHILIP A. LOOMIS, Jr.,
General Counsel,
Securities and Exchange Commission.

NOVEMBER 1968.

SUPREME COURT OF THE UNITED STATES

No. 41.—OCTOBER TERM, 1968.

Securities and Exchange Commission,
Petitioner,

v.

National Securities, Inc., et al.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

[January 27, 1969.]

MR. JUSTICE MARSHALL delivered the opinion of the Court.

This case raises some complex questions about the Securities and Exchange Commission's power to regulate the activities of insurance companies and of persons engaged in the insurance business. The Commission originally brought suit in the United States District Court for the District of Arizona, pursuant to § 21 (e) of the Securities Exchange Act of 1934, 48 Stat. 900, as amended, 15 U. S. C. § 78u (e). It alleged violations of § 10 (b) of the Act, 48 Stat. 891, 15 U. S. C. § 78j (b), and of the Commission's Rule 10b-5, 17 CFR § 240.10b-5 (1968). According to the amended complaint, National Securities and various persons associated with it had contrived a fraudulent scheme centering on a contemplated merger between National Life and Casualty Insurance Co. (National Life), a firm controlled by National Securities, and Producers Life Insurance Co. (Producers Life). The details of the alleged scheme are not important here. The Commission contended that National Securities purchased a controlling interest in Producers Life, partly from Producers' directors and partly in the form of treasury stock held by Producers. After taking control of Producers' board, the defendants sought to obtain

shareholder approval of the merger by sending communications to Producers' 14,000 stockholders. These communications, according to the Commission, contained misrepresentations of material facts and omitted to state material facts necessary to make the statements which were made not misleading. Among other things, the defendants allegedly failed to disclose their plan for the surviving company to assume certain obligations which National Securities had undertaken as part of the consideration for its purchases of Producers' stock. In plain language, Producers' shareholders were not told that they were going to pay part of the cost of National Securities' acquisition of control in their company.

The Commission was denied temporary relief, and shortly thereafter Producers' shareholders and the Arizona Director of Insurance approved the merger. The two companies were formally consolidated into National Producers Life Insurance Co. on July 9, 1965. Thereafter, the Commission amended its complaint to seek additional relief; the previously sought injunction forbidding further violations of Rule 10b-5 was to be supplemented by court orders unwinding the merger and returning the situation to the *status quo ante*, requiring the defendants to make an accounting of their unlawful gains, and readjusting the equities of the various defendants in whatever companies survived the decree. The Commission also requested whatever further relief the court might deem just, equitable, and necessary. Defendants moved for judgment on the pleadings, and the trial court dismissed the complaint for failure to state a claim upon which relief could be granted. The court ruled that the relief requested was either barred by §2 (b) of the McCarran-Ferguson Act, 59 Stat. 34 (1945), as amended, 15 U. S. C. § 1012 (b),¹ or was beyond the

¹ "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of reg-

scope of § 21 (e) of the Securities Exchange Act. 252 F. Supp. 623 (1966). The Ninth Circuit affirmed, relying on the McCarran-Ferguson Act. 387 F.2d 25 (1967). Upon application by the Commission, we granted certiorari because of the importance of the questions raised to the administration of the securities laws. 390 U. S. 1023 (1968).

I.

Insofar as it is relevant to this case, § 2 (b) of the McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance" Respondents contend that this Act bars the present suit since the Arizona Director of Insurance found that the merger was not "[i]nequitable to the stockholders of any domestic insurer" and not otherwise "contrary to law," as he was required to do under the state insurance laws. Ariz. Rev. Stat. § 20-731 (Supp. 1969). If the Securities Exchange Act were applied, respondents argue, these laws would be "superseded." The SEC sees no conflict between state and federal law; it contends that the applicable Arizona statutes did not give the State Insurance Director the power to determine whether respondents had made full disclosure in connection with the solicitation of proxies.² Although respondents dis-

ulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law."

² In 1966 Arizona law was amended to give him this power. See Ariz. Rev. Stat. § 20-143 (Supp. 1969). This statute was passed

agree, we do not find it necessary to inquire into this state-law dispute. The first question posed by this case is whether the relevant Arizona statute is a "law enacted . . . for the purpose of regulating the business of insurance" within the meaning of the McCarran-Ferguson Act. Even accepting respondents' view of Arizona law, we do not believe that a state statute aimed at protecting the interests of those who own stock in insurance companies comes within the sweep of the McCarran-Ferguson Act. Such a statute is not a state attempt to regulate "the business of insurance," as that phrase was used in the Act.

The McCarran-Ferguson Act was passed in reaction to this Court's decision in *United States v. South-Eastern Underwriters Assn.*, 322 U. S. 533 (1944). Prior to that decision, it had been assumed, in the language of the leading case, that "[i]ssuing a policy of insurance is not a transaction of commerce." *Paul v. Virginia*, 75 U. S. (8 Wall.) 168, 183 (1869). Consequently, regulation of insurance transactions was thought to rest exclusively with the States. In *South-Eastern Underwriters*, this Court held that insurance transactions were subject to federal regulation under the Commerce Clause, and that the antitrust laws, in particular, were applicable to them. Congress reacted quickly. Even before the opinion was announced, the House had passed a bill exempting the insurance industry from the anti-trust laws. 90 Cong. Rec. 6565 (1944). Objection in the Senate killed the bill, 90 Cong. Rec. 8054 (1944), but Congress clearly remained concerned about the inroads the Court's decision might make on the tradition of state regulation of insurance. The McCarran-Ferguson Act was the product of this concern. Its pur-

in response to the 1964 amendments to the Securities Exchange Act.
Pub. L. 88-467, 78 Stat. 565.

pose was stated quite clearly in its first section; Congress declared that "the continued regulation and taxation by the several States of the business of insurance is in the public interest." 59 Stat. 33 (1945), 15 U. S. C. § 1011. As this Court said shortly afterward, "[o]bviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance." *Prudential Insurance Co. v. Benjamin*, 328 U. S. 408, 429 (1946).

The question here is whether state laws aimed at protecting the interests of those who own securities in insurance companies are the type of laws referred to in the 1945 enactment. The legislative history of the McCarran-Ferguson Act offers no real assistance. Congress was mainly concerned with the relationship between insurance ratemaking and the antitrust laws, and with the power of the States to tax insurance companies. See, e. g., 91 Cong. Rec. 1087-1088 (remarks of Congressmen Hancock and Celler). The debates centered on these issues, and the Committee reports shed little light on the meaning of the words "business of insurance." See S. Rep. No. 20, 79th Cong., 1st Sess. (1945); H. R. Rep. No. 143, 79th Cong., 1st Sess. (1945). In context, however, it is relatively clear what problems Congress was dealing with. Under the regime of *Paul v. Virginia*, *supra*, States had a free hand in regulating the dealings between insurers and their policyholders. Their negotiations, and the contract which resulted, were not considered commerce and were, therefore, left to state regulation. The *South-Eastern Underwriters* decision threatened the continued supremacy of the States in this area. The McCarran-Ferguson Act was an attempt to turn back the clock, to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation. As the House Report makes clear, "[i]t [was] not the

intention of Congress in the enactment of this legislation to clothe the States with any power to regulate or tax the business of insurance beyond that which they had been held to possess prior to the decision of the United States Supreme Court in the *Southeastern Underwriters Association case*." H. R. Rep. No. 143, 79th Cong., 1st Sess., at 3 (1945).

Given this history, the language of the statute takes on a different coloration. The statute did not purport to make the States supreme in regulating all the activities of insurance companies; its language refers not to the persons or companies who are subject to state regulation, but to laws "regulating the business of insurance." Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the "business of insurance" does the statute apply. Certainly the fixing of rates is part of this business; that is what *South-Eastern Underwriters* was all about. The selling and advertising of policies, *FTC v. National Casualty Co.*, 357 U. S. 560 (1958), and the licensing of companies and their agents, cf. *Robertson v. California*, 328 U. S. 440 (1946), are also within the scope of the statute. Congress was concerned with the type of state regulation that centers around the contract of insurance, the transaction which *Paul v. Virginia* held was not "commerce." The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement—these were the core of the "business of insurance." Undoubtedly, other activities of insurance companies relate so closely to their status as reliable insurers that they too must be placed in the same class. But whatever the exact scope of the statutory term, it is clear where the focus was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting or regulating this

relationship, directly or indirectly, are laws regulating the "business of insurance."

In this case, Arizona is concerning itself with a markedly different set of problems. It is attempting to regulate not the "insurance" relationship, but the relationship between a stockholder and the company in which he owns stock. This is not insurance regulation, but securities regulation. It is true that the state statute applies only to insurance companies. But mere matters of form need not detain us. The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

This reading of the Act is implicit in this Court's past decisions. Less than two years ago the Court approved the application of the registration requirements of the Securities Act of 1933, § 5, 48 Stat. 77, 15 U. S. C. § 77e, to certain annuity contracts issued by insurance companies. *SEC v. United Benefit Life Insurance Co.*, 387 U. S. 202 (1967). The Court explicitly rejected arguments based on the McCarran-Ferguson Act in a similar case of slightly earlier vintage. *SEC v. Variable Annuity Life Insurance Co.*, 359 U. S. 65, 67-68 (1959). Although the securities laws contain a number of exemptions relating to insurance and insurance companies,³ the Commission has traditionally regulated a number of activities related to insurance securities.⁴ Of course, under the securities laws state regulation may co-exist

³ *E. g.*, Securities Act of 1933, § 3 (a) (8), 48 Stat. 76, 15 U. S. C. § 77c (a) (8); Securities Exchange Act of 1934, § 12 (g) (2) (G), added by Pub. L. 88-467, 78 Stat. 567 (1964), 15 U. S. C. § 78l (g) (2) (G).

⁴ The Commission lists a large number of examples of its activities in its brief. Brief for Petitioner, at 16-17.

with that offered under the federal securities laws. See, *e. g.*, Securities Act of 1933, § 18, 48 Stat. 85, 15 U. S. C. § 77r; Securities Exchange Act of 1934, § 28 (a), 48 Stat. 903, 15 U. S. C. § 78bb (a). But it has never been held that state regulation of insurance securities pre-empts federal regulation, on the theory that the federal securities laws would be "superseding" state laws regulating the "business of insurance." The fact that Arizona purports to protect the interests of insurance company stockholders does not, therefore, by itself render the federal securities laws inapplicable.

II.

The fact remains, however, that the State of Arizona has approved a merger between two insurance companies which, as a matter of remedies, the Securities and Exchange Commission seeks to unwind. Moreover, Arizona has approved the merger not only under its laws relating to insurance securities but also in its capacity as licensor of insurers within the State. The applicable statute requires the State Director of Insurance to find that the proposed merger would not "substantially reduce the security of and service to be rendered to policyholders" before he gives his approval. Ariz. Rev. Stat. § 20-731 (B)(3) (Supp. 1960). This section of the statute clearly relates to the "business of insurance." The question is, then, whether the McCarran-Ferguson Act bars a federal remedy which affects a matter subject to state insurance regulation. In the circumstances of this particular case, we do not think it does; without intimating any opinion about what remedies would be appropriate should a violation be found after a trial on the merits, we hold that the McCarran-Ferguson Act furnishes no reason for refusing the remedies the Commission is seeking.⁵

⁵ Although the District Court held that some of the relief requested was beyond that properly allowable under § 21 (e) of the 1934 Act,

The Commission alleged that approval of the merger was obtained through the use of various fraudulent misrepresentations. It did not ask the trial court to pass directly upon a merger which the State Director of Insurance had approved. No question of the legality or illegality of the merger, standing alone, was raised. The gravamen of the complaint was the misrepresentation, not the merger. The merger became relevant only insofar as it was necessary to attack it in order to undo the harm caused by the alleged deception. Presumably, full disclosure would have avoided the particular Rule 10b-5 violation alleged in the complaint. Nevertheless, respondents contend that any attempt to interfere with a merger approved by state insurance officials would "invalidate, impair, or supersede" the state insurance laws made paramount by the McCarran-Ferguson Act. We cannot accept this overly broad restriction on federal power.

It is clear that any "impairment" in this case is a most indirect one. The Federal Government is attempting to protect security holders from fraudulent misrepresentations; Arizona, insofar as its activities are protected by the McCarran-Ferguson Act from the normal operations of the Supremacy Clause, is attempting to protect the interests of the policyholders. Arizona has not commanded something which the Federal Government seeks to prohibit. It has permitted respondents to consummate the merger; it did not order them to do so. In this context, all the Securities and Exchange Commission is asking is that insurance companies speak the truth when talking to their shareholders. The paramount federal interest in protecting shareholders is in this situation

48 Stat. 900, as amended, 15 U. S. C. § 78u (e), no such question has been argued by either party here. Accordingly, we express no opinion about the proper construction of that section. See Note, Ancillary Relief in SEC Injunction Suits for Violation of Rule 10b-5, 79 Harv. L. Rev. 656 (1966).

perfectly compatible with the paramount state interest in protecting policyholders. And the remedy the Commission seeks does not affect a matter predominately of concern to policyholders alone; the merger is at least as important to those owning the companies' stock as it is those holding their policies. In these circumstances, we simply cannot see the conflict. Different questions would, of course, arise if the Federal Government were attempting to regulate in the sphere reserved primarily to the States by the McCarran-Ferguson Act. But that is not this case. In these circumstances, there is no reason to emasculate the securities laws by forbidding remedies which might prove to be essential. Cf. *J. I. Case Co. v. Borak*, 377 U. S. 426 (1964). On remand, the trial court may order a return to the *status quo ante* if it finds that course of action desirable, necessary, and otherwise lawful.

III.

Respondents argue that there are alternative grounds on which the lower courts' action in granting judgment on the pleadings can be sustained. They contend that the complaint fails to allege a "purchase or sale" of securities within the meaning of §10 (b) and the Commission's Rule 10b-5, and that in any case Rule 10b-5 does not apply to misrepresentations in connection with the solicitation of proxies.* Since this case is here in

*Section 10 (b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U. S. C. § 78j (b), provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or

the context of an appeal from the pretrial dismissal of a complaint, a simple remand would leave the lower courts with nothing more on which to base a decision than the record presently before this Court. In addition, further delays in resolving this controversy might increase the difficulty of fashioning effective relief. Accordingly, we think it desirable to dispose of these two issues before remanding the case so that the trial court may go forward with further proceedings without undue delay.

Although § 10 (b) and Rule 10b-5 may well be the most litigated provisions in the federal securities laws, this is the first time this Court has found it necessary to interpret them. We enter this virgin territory cautiously. The questions presented are narrow ones. They arise in an area where glib generalizations and unthinking abstractions are major occupational hazards. Accordingly, in deciding this particular case, remembering what is not involved is as important as determining what is. With this in mind, we turn to respondents' particular contentions.

Respondents argue that the complaint fails to allege any misstatements "in connection with the purchase or

Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 CFR § 240.10b-5 (1968), provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or if the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

sale of any security," as is required by both the statute and the rule. They rely upon the so-called "no-sale doctrine" presently set forth in the Commission's Rule 133 under the Securities Act of 1933, 17-CFR § 230.133 (1968). That rule, promulgated under the Commission's authority to define "accounting, technical, and trade terms" used in the 1933 Act, § 19 (a), 48 Stat. 85, as amended, 15 U. S. C. § 77a, sets forth various situations involving statutory mergers and other types of corporate reorganizations, and declares that no "sale" or "offer" shall be deemed to be involved. But whatever may be the validity or effect of this rule—and we intimate absolutely no opinion on these questions—it certainly does not determine the result here. The rule is specifically made applicable only to cases involving § 5 of the 1933 Act; this case arises under § 10 (b) of the 1934 Act. Although the interdependence of the various sections of the securities laws is certainly a relevant factor in any interpretation of the language Congress has chosen, ordinary rules of statutory construction still apply. The meaning of particular phrases must be determined in context, *SEC. v. C. M. Joiner Leasing Corp.*, 320 U. S. 344, 350-351 (1943). Congress itself has cautioned that the same words may take on a different coloration in different sections of the securities laws; both the 1933 and the 1934 Acts preface their lists of general definitions with the phrase "unless the context otherwise requires." 1933 Act, § 2, 48 Stat. 74, 15 U. S. C. § 77b; 1934 Act, § 3, 48 Stat. 882, 15 U. S. C. § 78c. We must therefore address ourselves to the meaning of the words "purchase or sale" in the context of § 10 (b). Whatever these or similar words may mean in the numerous other contexts in which they appear

¹ For the history of this doctrine, see 1 L. Loss, *Securities Regulation* 518-542 (1961).

in the securities laws, only this one narrow question is presented here.

Section 10 (b) and Rule 10b-5 together constitute one of the several broad antifraud provisions contained in the securities laws. In the context of this case, the Commission seeks to apply them to prevent the shareholders of Producers Life from being defrauded as a result of misstatements made by respondents. For the statute and the rule to apply, the allegedly proscribed conduct must have been "in connection with the purchase or sale of any security." The relevant definitional sections of the 1934 Act are for the most part unhelpful; they only declare generally that the terms "purchase" and "sale" shall include contracts to purchase or sell. §§ 3 (a)(13), 3 (a)(14), 48 Stat. 884, 15 U. S. C. §§ 78c (a)(13), 78c (a)(14).⁸ Consequently, we must ask whether respondents' alleged conduct is the type of fraudulent behavior which was meant to be forbidden by the statute and the rule.

According to the amended complaint, Producers Life's shareholders were misled in various material respects prior to their approval of a merger. The deception furthered a scheme which resulted in their losing their status as shareholders in Producers Life and becoming shareholders in a new company. Moreover, by voting in favor of the merger, each approving shareholder individually lost any right under Arizona law to obtain an appraisal of his stock and payment for it in cash. Ariz. Rev. Stat. § 10-347 (1956). Whatever the terms "purchase" and "sale" may mean in other contexts, here an alleged deception has affected individual shareholders' decisions in ways not at all unlike that involved in a

⁸ These sections do indicate the breadth of the statutory terms by using the definitional word "include" and by including within the definitions contracts "to buy, purchase or otherwise acquire" and "to sell or otherwise dispose of" securities.

typical cash sale or share exchange. The broad anti-fraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation. Therefore we conclude that Producers Life's shareholders "purchased" shares in the new company by exchanging them for their old stock.* As the Court of Appeals for the Seventh Circuit has said, "This view does no violence to the statutory language, and is the present interpretation of the body which is responsible for the administration of the acts," *Dasho v. Susquehanna Corp.*, 380 F. 2d 262, 269 (opinion of Fairchild and Cummings, JJ.), cert. denied, 389 U. S. 977 (1967); see *Vine v. Beneficial Finance Co.*, 374 F. 2d 627 (C. A. 2d Cir.), cert. denied, 389 U. S. 970 (1967); cf. *Ruckle v. Roto American Corp.*, 339 F. 2d 24 (C. A. 2d Cir. 1964).

Respondents' alternative argument that Rule 10b-5 does not cover misrepresentations which occur in connection with proxy solicitations can be dismissed rather quickly. Section 14 of the 1934 Act, 48 Stat. 895, 15 U. S. C. § 78n, and the rules adopted pursuant to that section, 17 CFR §§ 240.14a-1 to 240.14a-103 (1968), set up a complex regulatory scheme covering proxy solicitations. At the time of the conduct charged in the complaint, these provisions did not apply to respondents; the 1964 amendments to the Securities Exchange Act would have made them applicable later if certain conditions relating to state regulation had not been met. 78 Stat. 567, 15 U. S. C. § 78l (g)(2)(G). But the ex-

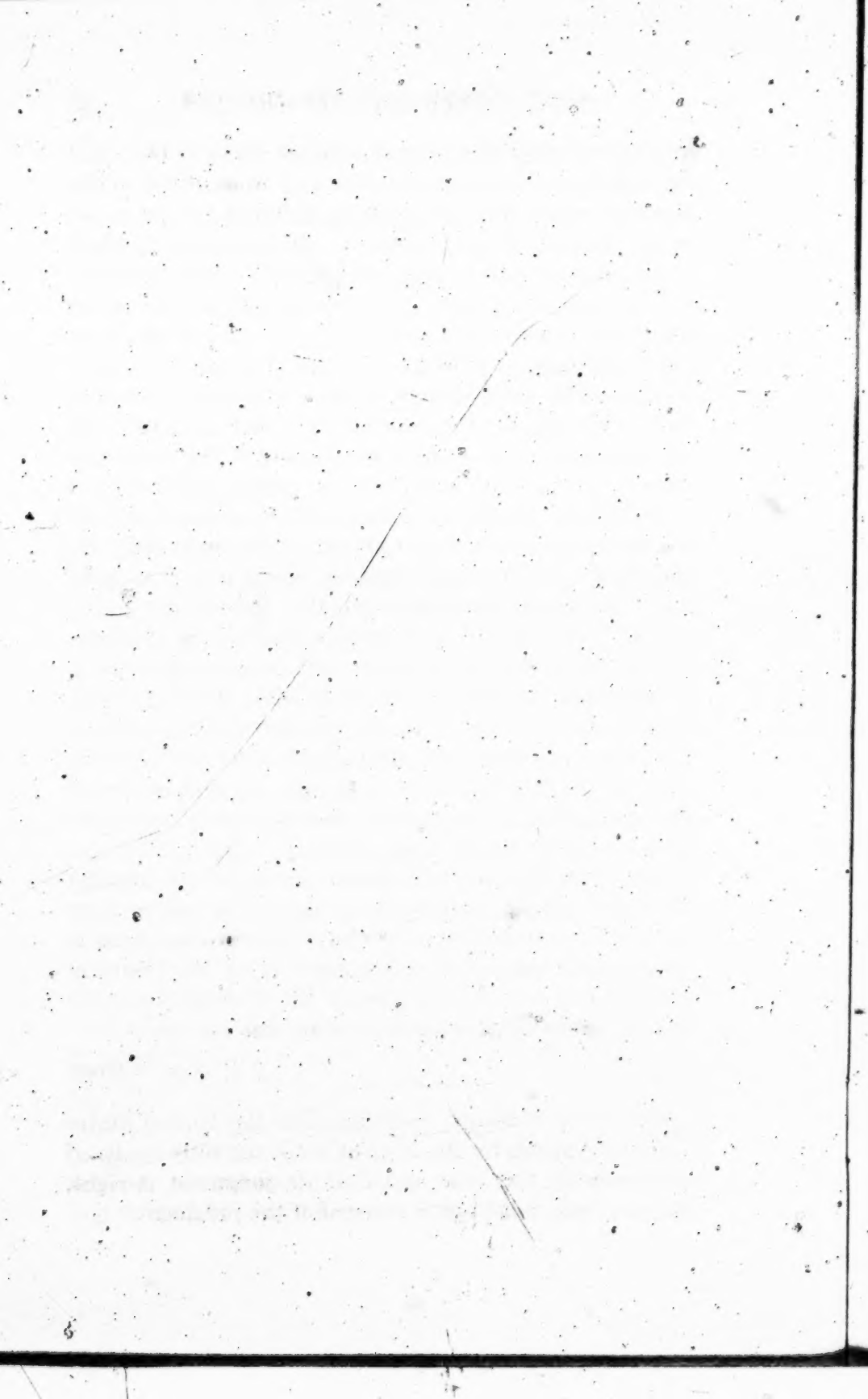
* This case presents none of the complications which may arise in determining who, if anyone, may bring private actions under § 10 (b) and Rule 10b-5. Cf. *J. I. Case Co. v. Borak*, 377 U. S. 426 (1964). This is a suit brought by the Commission; the terms "purchase" and "sale" are relevant only to the question of statutory coverage. Therefore there are no "standing" problems lurking in the case. Cf. Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 Va. L. Rev. 268 (1968).

istence or nonexistence of regulation under § 14 would not affect the scope of § 10 (b) and Rule 10b-5. The two sections of the Act apply to different sets of situations. Section 10 (b) applies to all proscribed conduct in connection with a purchase or sale of any security; § 14 applies to all proxy solicitations, whether or not in connection with a purchase or sale. The fact that there may well be some overlap is neither unusual nor unfortunate. Nor does it help respondents that insurance companies may often be exempt from federal proxy regulation under the 1964 amendments. The securities laws' exemptions for insurance companies and insurance activities are carefully limited. None is applicable to the Rule 10b-5 situation with which we are confronted, and we do not have the power to create one. Congress may well have concluded that the Commission's general antifraud powers over purchases and sales of securities should continue to apply to insurance securities, even though the more detailed regulation of proxy solicitations—which may often be conducted in connection with the managerial activities of insurance companies—were left to the States. Accordingly, we find no bar to the application of Rule 10b-5 to respondents' misstatements in their proxy materials.

Since the McCarran-Ferguson Act does not prohibit the relief sought, and since neither of the alternative grounds for dismissal which have been raised here is meritorious, we reverse the judgment of the Court of Appeals and remand the case to the District Court for further proceedings consistent with this opinion.

It is so ordered.

MR. JUSTICE BLACK, believing that the United States Court of Appeals for the Ninth Circuit correctly analyzed the issues in this case and that its judgment is right, dissents from this Court's reversal of the judgment.



SUPREME COURT OF THE UNITED STATES

No. 41.—OCTOBER TERM, 1968.

Securities and Exchange Commission,
Petitioner,

v.

• National Securities, Inc., et al.

On Writ of Cer-
tiorari to the
United States
Court of Ap-
peals for the
Ninth Circuit.

[January 27, 1969.]

MR. JUSTICE HARLAN, whom MR. JUSTICE STEWART joins, concurring in part and dissenting in part.

I concur entirely in Parts I and II of the Court's opinion construing the McCarran-Ferguson Act. But I am at a loss to understand why the Court finds it necessary to go further and construe Rule 10b-5 promulgated under § 10 (b) of the Securities Exchange Act of 1934. The Court of Appeals did not reach this question since it believed that the McCarran-Ferguson Act entirely exempted the transaction involved here from the commands of the federal securities laws. The Government's petition for certiorari is similarly limited. The only issue it raises is "whether the McCarran-Ferguson Act . . . precludes the application of the anti-fraud provisions of the Securities Exchange Act of 1934. . . ." See Petition for Certiorari, p. 2. When the respondent's brief on the merits argued that Rule 10b-5 did not apply to the present case, the Solicitor General did not even attempt to present the Government's position on that score because he quite properly believed that "the question is not appropriately before this Court for decision." Government's Reply Brief, p. 2.

Despite the fact that we have not heard the views of the Securities and Exchange Commission, the Court

2 SEC v. NATIONAL SECURITIES.

chooses this case as a vehicle to construe for the first time one of the most important and elusive provisions of the securities laws. Moreover, the decision has far-reaching radiations, despite the fact that the precise issue presented is a narrow one. Courts and commentators have long debated whether Rule 10b-5 should be read as a sweeping prohibition against fraud in the securities industry when this results in rendering nullities of the other antifraud provisions of more limited scope which can be found in the statute books. See, e. g., §§ 11(a), 12(2), 13 of the Securities Act of 1933; § 18 of the Securities and Exchange Act of 1934. The late Judge Jerome Frank,¹ Professor Loss,² and Milton Cohen,³—to mention only three of those particularly eminent in this field—have warned that Rule 10b-5 should not be construed to supersede the special statutory schemes which Congress has devised to assure fair dealing in various aspects of the securities business. But see, Bromberg, Securities Law § 2.5 (1967); *Ellis v. Carter*, 291 F. 2d 970 (1961). Even those who take an extremely broad view of the scope of the Rule have recognized that it could well be argued that the courts should not rush in to apply § 10(b) to regulate proxy solicitations where Congress has refused to permit the Commission to intervene under § 14. See, Bromberg, *supra*, § 6.5(2), n. 93.1. Indeed, at one time the SEC itself was of the opinion that the Rule did not apply in cases of this sort. *National Supply Co. v. Leland Stanford University*, 134 F. 2d 689, 694 (1943). Nevertheless, the majority believes it can answer this question "rather quickly," *ante*, at 14, without any real recognition of the basic principles which hang in the balance.

¹ *Fischman v. Raytheon Manufacturing Co.*, 188 F. 2d 783 (1951).

² 3 Securities Regulation 1787-1791 (1961).

³ "Truth in Securities" Revisited, 79 Harv. L. Rev. 1340, 1370 n. 89 (1966).

In addition, the Court has chosen to adopt a very loose construction of the requirement, first enunciated by Judge Augustus Hand in *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (1951), cert. denied 343 U.S. 956 (1952), that a transaction must involve a "purchase" or "sale" of securities before it may be found to violate Rule 10b-5. While some commentators have welcomed the erosion of this doctrine, see Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 Va. L. Rev. 268 (1968), especially in injunction actions initiated by the SEC, Note, *The Purchaser-Seller Limitation to SEC Rule 10b-5*, 53 Cornell L. Rev. 684, 694-697 (1968), others believe that "*Birnbaum* seems basically correct." 3 Loss, *Securities Regulation* at 1469. As recently as 1964, the Second Circuit rendered a decision which has been commonly understood to have reaffirmed the vitality of the *Birnbaum* doctrine, with my Brother MARSHALL casting the deciding vote. *O'Neill v. Maytag*, 339 F. 2d 764, 768 (1964);⁴ see Lowenfels, *supra*, at 270.

I am unwilling to decide these fundamental matters without full-dress argument. Indeed, if the courts of appeals are not to be permitted to develop the law in this area on a case-by-case basis, I think it much wiser for us to consider the basic issues in a case which squarely raises them rather than in one which is of marginal importance.

⁴ Both *O'Neill* and *Birnbaum* were of course private actions, and I do not mean to suggest that my Brother MARSHALL is flatly inconsistent in now ruling that the "purchase" and "sale" requirement has been met in this case involving the SEC's request for an injunction. Nevertheless, both private and public actions arise under the same Rule, and the legal problems involved in the two situations, while not identical, are closely related.